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DISCLAIMER

It should be noted that the material in this book is designed to provide general information only. It is not offered as advice on any particular matter, whether it be legal, procedural or other, and should not be taken as such. The laws and regulations summarized in this book are current as of 1 January 2013. The authors expressly disclaim all liability to any person in respect of the consequences of anything done or omitted to be done wholly or partly in reliance upon the whole or any part of the contents of this book. No reader should act or refrain from acting on the basis of any matter contained in it without seeking specific professional advice on the particular facts and circumstances at issue.

This may qualify as "Attorney Advertising" requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome.
Australia has a healthy and vigorous mergers and acquisitions ("M&A") market. Asian investors in particular continue to enter the Australian market. Continued strength is apparent in the resources and energy sector (particularly in offshore focused miners).

There is also strong foreign and domestic interest in the food, agribusiness, bioscience and clean energy sectors.

Both hostile and negotiated takeover bids are frequently made for the shares of listed companies. Australia is regularly featured in the world’s top 10 for national merger and acquisition activity.

The Australian government welcomes foreign investment, which can take a number of forms, including setting up a new company, investing in an existing entity or establishing a joint venture. The government also encourages foreign corporations to locate their South Asian regional headquarters in Australia and has been promoting Australia as the gateway to South Asia.

Australian law applicable to Australian incorporated companies is derived from two sources: Australian common law ("case law") and Australian federal and state statutes, the principal one being the Corporations Act 2001 ("Corporations Act"). The Corporations Act is administered by a federal government organization, the Australian Securities and Investments Commission ("ASIC"). Listed companies must also comply with the Australian Stock Exchange Limited ("ASX") Listing Rules. Foreign investment in Australia is governed by the Foreign Acquisitions and Takeovers Act 1975 ("Foreign Acquisitions Act").
Investment Overview

Australia has a diversified economy, with a particularly strong primary industries base. In the past few years, specific areas that have undergone significant merger and investment activity include energy, financial services, property and investment trusts, information technology/telecommunications, transport/utilities, media and mining, oil and gas.
Business acquisition in Australia usually takes the form of either an asset acquisition, when the assets of a business are purchased, or a share acquisition. A share acquisition may proceed by way of:

- the purchase of shares in an Australian company (direct share acquisition); or
- the purchase of shares in a non-Australian corporation which holds the shares of the Australian company (indirect share acquisition).

The legal consequences may differ, depending upon whether the share acquisition is direct or indirect.

The possible advantages and disadvantages of each form of acquisition from a legal perspective are outlined below.

Share Acquisition

**Advantages**

- A sale of shares is often simpler than a sale of assets. In an asset sale, it is necessary to separately deal with each category of asset and assumed liability. For example, existing third-party contracts (such as leases, contracts with suppliers and customers, licenses and permits, intellectual property and employees) can be transferred by mutual agreement.
• Profit on the sale of shares may be tax-free for sellers who have held the shares prior to 20 September 1985 (the date Australia introduced capital gains tax).

• Stamp duty payable by the buyer on a share acquisition in a private company is significantly less (and may be nil depending on the place of incorporation of the target company) than on an asset sale, provided that the target company does not hold land assets.

• Stamp duty should not be payable on a share acquisition in a listed company whose shares are quoted on the ASX or another recognized stock exchange where the company has land. However, duty may apply in the case of a takeover.

Disadvantages

• The sale of the shares of the target company involves the sale of the target company, together with all liabilities (including contingent or undisclosed liabilities such as undisclosed tax liabilities, breaches of legislation affecting the business and claims by customers or employees) that may have an impact on the value of the shares to be sold. Under a sale of assets, the seller retains all liabilities not specifically assumed by the buyer.

• As the buyer would acquire the target company together with all liabilities (including contingent or undisclosed liabilities), due diligence enquiries relating to the acquisition of shares would generally be more extensive. Further, more extensive warranties and indemnities in the sale agreement may be required to deal with these risks. This particularly applies in relation to taxation aspects.

• In certain circumstances, it may be more difficult for a buyer to arrange for finance for a share acquisition compared to an asset acquisition due to the greater perceived risks of a share acquisition.

Asset Acquisition

Advantages

• The seller may more easily select which assets it wishes to divest and may find it desirable to retain the corporate entity in order to utilize tax losses.

• The buyer can be more selective when deciding which assets to purchase and precise about the extent of liabilities being assumed and is therefore less exposed to contingent or undisclosed liabilities. This is particularly important where there is concern relating to contingent or undisclosed liabilities of the company for which adequate provision cannot be made at the time of purchase.
• Due diligence enquiries relating to the acquisition of assets would generally be less extensive than compared to a sale of shares. This usually results in less warranties and indemnities in the sale agreement.

• As discussed further below, although a company may be prohibited from financially assisting the acquisition of its own shares, it is not prohibited from assisting with the acquisition of its own assets.

Disadvantages

• A sale of assets is often more logistically complex than a sale of shares as it is necessary to separately deal with each category of asset and assumed liability.

• Stamp duty of up to 6.75% (depending on the state or territory in which the particular asset is located) is payable by the buyer on the transfer or assignment of certain assets. In some jurisdictions, the duty liability is joint and several as between the buyer and the seller although the usual commercial practice is to contractually shift the liability on to the buyer.

• It can be necessary to obtain third-party consents for formal assignments of novations of contracts, leases, licenses and permits.

• Sometimes, goods and services tax ("GST") is payable with respect to a sale of assets (see below for details).

Acquisitions Versus Joint Ventures

Commercial considerations (such as particular know-how, patents, local contacts and funding) and, to a lesser extent, federal government regulation of foreign investment, will dictate whether a transaction will take the form of a 100% acquisition or a joint venture.

If a joint venture model is chosen, it may be incorporated or unincorporated. Unlike in the US, an unincorporated joint venture is not a legal entity distinct from the venturers but simply a contractual relationship between each of the venturers. Unless careful attention is paid to the structuring of obligations in the joint venture contract, it may be construed as a partnership with the result that each partner will be liable for the acts of the other partner(s).

An incorporated joint venture simply superimposes the business relationship between the co-venturers on the corporate structure. The constitution of the joint venture company as it relates to the powers of the board and shareholders, procedural formalities, voting requirements and so on, is appropriately modified. For example, provision is generally made for the nominee directors of each
Mergers

A procedure known as a Scheme of Arrangement is available in Australia under which two companies may merge, subject to the approval of a state Supreme Court and the target’s shareholders in general meeting. The shareholder approval thresholds are:

- a special resolution of shareholders, which requires at least 75% of the number of votes cast on the resolution to be in favor of the scheme; and
- approval from at least 50% of the number of shareholders who vote on the resolution, regardless of how many shares they hold.

Although this procedure is becoming more common in the listed company arena, it is generally used less frequently than a direct share or asset acquisition. However, it may have particular advantages depending on the characteristics of the target entity and whether special corporate actions need to be undertaken in connection with the transaction, such as amending the target’s constitution or approving a share buy-back.

Schemes of Arrangement are also popular in private-equity funded “public to private” transactions where they offer greater flexibility than public company takeovers. For example, different kinds of shareholders can be offered different kinds of consideration.

Foreign Versus Domestic Investment Considerations

Accounting Issues

Accounting issues, such as the amortization of goodwill, may impact on an acquisition structure. Australian companies that are required to prepare financial statements now do so under International Financial Reporting Standards, bringing Australian accounting practices into line with international standards.
Investment in Listed Companies

A foreign investor seeking to invest in a listed company may invest directly through an Australian based stockbroker or, in some cases, through American Depositary Receipts (“ADRs”).

Direct investment - The ASX is highly computerized and has an electronic trading system called SEATS, which replaced the open outcry system. In 2004, the ASX moved to an integrated trading system called CLICK XT that offers new trading possibilities, such as contingent trading across equities and derivatives.

The ASX has also introduced CHESS, which is an electronic clearinghouse that facilitates the paperless transfer of securities within three business days. Investors do not receive share certificates but instead receive a statement of their current shareholding. This system facilitates direct investment by foreign investors and is recognition of the growth of a global securities market. Although CHESS cannot be used for companies incorporated in a jurisdiction whose laws do not recognize electronic security holdings or electronic transfers, the ASX has developed CHESS Depositary Interests (“CDIs”) to overcome this difficulty. CDIs provide a method of transferring and holding foreign securities in CHESS through a nominated company sponsor.

Investment through ADRs - An alternative to investing directly on ASX is to invest in ADRs. More than 200 Australian companies have instituted sponsored ADR programs. Most of these ADRs are traded on the NASDAQ Bulletin Board and are not quoted on a US securities exchange. However, an increasing number of Australian companies are considering US listings, particularly on NASDAQ.

The advantages for US investors of investing in ADRs are as follows:

- Transfers take place on the depositary’s books in the US rather than in Australia.
- US investors need not be concerned with currency conversion or with establishing an Australian bank account.
- Settlements of sales of ADRs are in US dollars and within the customary US settlement period.
- ADRs have a market value denominated in US dollars.
- ADRs may be traded in the US.
- US investors receive dividends in US dollars (after the conversion by the depositary of the Australian dollar dividends).
• ADRs are designed to have a market value that is typical of the trading value of US securities. For example, an Australian mining company’s shares may trade at AUD0.30. Under the ADR facility, one ADR may represent 10 Australian ordinary shares. Those ADRs would trade at about USD3.00 (assuming AUD1 = USD1).

• An ADR holder may engage in arbitrage transactions by requesting the depositary to sell the underlying Australian shares and account to the holder for the proceeds. The ADR holder may thus seek to take advantage of any discrepancies that exist between the trading value of the ADR in the US and the trading value of the shares in Australia.
Foreign Investment Restrictions

The Foreign Acquisitions Act regulates the direct and indirect acquisition of Australian corporations and businesses by foreign interests. Under the Foreign Acquisition Act, “foreign persons” or corporations may be required to notify and obtain the consent of the Commonwealth Treasurer of Australia (“Treasurer”) to, either alone or together with associates:

- acquire a “substantial interest” in an Australian company or business that is valued above AUD248 million (indexed annually); or
- implement a takeover for an offshore company that has Australian subsidiaries or assets valued above AUD248 million (indexed annually).

A substantial interest occurs when a single person (and any associates) acquires 15% or more of an Australian company or when two or more persons (and any associates) acquire 40% of an Australian company.

A brief summary of the application of the Foreign Acquisitions Act (other than for US investors) is set out in Appendix B.

Notification and Consent

In the majority of industry sectors (excluding the sensitive industry sectors discussed below) smaller proposals are exempt from notification and larger proposals are approved unless certain valuation thresholds are exceeded and the transaction is judged to be contrary to the national interest. Special rules apply to the direct or indirect acquisition of different types of Australian real estate.
In summary, if the value of the gross assets of the target is greater than AUD248 million, consent must be obtained from the Treasurer. This valuation threshold is raised to AUD1078 million where the investment is to be made by certain individuals or entities from the US by virtue of the Free Trade Agreement between Australia and the US that came into force on 1 January 2005.

Broadly speaking, if a financial threshold is exceeded, the Treasurer will determine what is contrary to the “national interest” by having regard to community concerns, and will generally consider if (among other things):

- the foreign investment proposal would lead directly or indirectly to net economic benefits for Australia; and
- subsequent to the acquisition, the business will continue to follow practices consistent with Australia’s interests.

Failure to obtain consent for a prescribed investment is an offense under the Foreign Acquisitions Act and may lead to the Treasurer making a divestiture order. Such an order requires the buyer to dispose of the assets acquired within a stipulated period of time.

Sensitive Industries

Specific restrictions apply to foreign investment in sensitive industries, which include banking, shipping, civil aviation, airports, media and telecommunications. The Treasurer has published guidelines for investment in these industries that should be carefully considered when planning an investment.

Approval Time

The Treasurer will usually, in accordance with the requirements of the Foreign Acquisitions Act, make a decision within 30 days of receiving an application, and notify the applicant of that decision within 10 days thereafter. Generally, if the Treasurer has not responded within 40 days of being notified of a proposed foreign investment, consent is deemed to have been given. It would only be in exceptional circumstances that consent would not be given or that an interim order would be made by the Treasurer to extend the period of time for considering an application by 90 days. However, consent may be given subject to any conditions which the Treasurer considers necessary.
Conditions to be Fulfilled to Obtain Approval

An application generally contains background information on the target, buyer and seller (including details of the major business activities, business locations, group ownership structures and the most recent financial statements), nature of the proposed acquisition, a statement of the buyer intentions and, where the acquisition is in an area deemed to be sensitive in terms of the national interest, an outline of the benefits of the proposed acquisition for Australia.

For certain industries (e.g., banking and broadcasting), additional legislation restricts foreign investment. Furthermore, the constitutions (or bylaws) of certain companies (including companies recently privatized) may restrict foreign investment.

Less Onerous Foreign Investment Restraints for US Investors

On 1 January 2005, the US Free Trade Agreement Implementation Act 2004 ("Implementation Act") came into force to give effect to the Free Trade Agreement between Australia and the US. Under the Implementation Act, which amended the Foreign Acquisitions Act, an investment made by a “prescribed foreign investor” (being a US national or US enterprise), will only require approval of the Treasurer if it involves:

- an acquisition of a “substantial interest” in an Australian company with gross assets valued at more than AUD1078 million (indexed annually); or
- an acquisition of a substantial interest in an offshore company that has Australian subsidiaries or assets valued above AUD1078 million (indexed annually).

In addition, for a “prescribed foreign investor”:

- all direct investment in new Australian businesses will be exempt from foreign investment approval; and
- investments in “prescribed sensitive sectors” will be subject to the approval threshold of AUD248 million (indexed annually).

For these purposes, the “prescribed sensitive sectors” are:

- media;
- telecommunications;
- transport;
the supply/training of people or goods and equipment to the Australian Defence Force;
the manufacture or supply of goods, equipment and technology to be used for a military purpose;
the development, manufacture or supply of, or provision of services in relation to, encryption and security technologies and communications systems; and
the extraction of uranium or plutonium or the operation of nuclear facilities.

Australia has also signed an Investment Protocol with New Zealand on 16 February 2011 which, once implemented, will provide New Zealand investors with the same higher thresholds that apply to US investors.

**Other Free Trade Agreements**

Australia has Free Trade Agreements with the following countries and associations:

- Chile
- Malaysia
- New Zealand (Closer Economic Relations)
- Singapore
- Thailand
- Association of South East Asian Nations ("ASEAN") and New Zealand

Australia is in negotiations with the following countries and associations to establish Free Trade Agreements:

- China
- India
- Indonesia
- Japan
- Korea
- Gulf Cooperation Council
- Pacific Agreement
- Regional Comprehensive Economic Partnership
- Trans-Pacific Partnership Agreement
Competition Law

Section 50 of the Trade Practices Act 1974 ("Trade Practices Act") prohibits mergers and acquisitions which have the effect, or likely effect, of substantially lessening competition in a substantial market in Australia.

While there is no mandatory pre-merger notification requirement in the Trade Practices Act, the current merger guidelines of the Australian Competition and Consumer Commission ("ACCC") encourage merger parties to notify the ACCC well in advance of completing a merger where both of the following apply:

- The products of the merger parties are either substitutes or complements.
- The merged firm will have a post-merger market share of greater than 20% in the relevant market/s.

If this notification threshold is satisfied, then it is usually advisable to notify the ACCC of the proposed acquisition. There are three methods of obtaining merger clearance:

- Informal clearance from the ACCC
- Formal clearance from the ACCC
- Authorization granted by the Australian Competition Tribunal ("Tribunal")

The informal clearance process is by far the most common form of review. The three merger review processes are outlined briefly below.

Merger parties who proceed without seeking ACCC clearance are at risk that the ACCC will form the view (on its own initiative or as a result of third-party complaint) that the merger has anti-competitive effects. Relevantly, the ACCC has extensive powers to obtain an injunction to prevent the merger from occurring or, if the merger has already occurred, to obtain penalties against the merger parties and/or to seek divestiture of the acquired assets.

Informal Clearance

The informal merger clearance process involves preparing a written submission to the ACCC that provides background information on the parties, information about the proposed merger and an analysis of the impact of the merger on competition in the relevant market. There is no filing fee in respect of informal clearances.
After receipt of the submission, the ACCC will conduct an initial assessment to determine whether it needs to conduct a more substantial review. A more substantial review would include market inquiries, i.e., the ACCC seeking the views of other market participants (such as customers, suppliers and competitors) about the impact of the proposed merger on competition.

If market inquiries are not required, informal clearance will generally be provided within two to four weeks. While the ACCC tries to accommodate commercial timeframes, if it determines that market inquiries are required (which it does in nearly all cases where the merger thresholds are breached), the process is likely to take approximately six to eight weeks.

In those cases where the ACCC considers that there are competition issues, the ACCC will publish a Statement of Issues and establish a secondary timeline for further consideration of the merger. This further review process (which is likely to include another round of market inquiries) is likely to take up to an additional six weeks to complete (and potentially longer depending on the complexity of the issues raised for consideration).

Informal clearance can be sought from the ACCC on either a public or confidential basis. Confidential reviews are usually sought where the fact of the proposed transaction is confidential. With confidential reviews, the ACCC may determine that it is unable to provide the parties with an unqualified final view about the acquisition on the strength of the confidential review alone, and that it will need to make market inquiries before it can reach a conclusion.

At the conclusion of the process, if the ACCC does not oppose the merger, it will issue a “no action” letter advising that the ACCC does not propose to oppose the merger. In some instances, the ACCC seeks to impose conditions on the provision of informal clearance, including through the provision of court enforceable undertakings. These conditions may take the form of a requirement to divest part of the business or assets.

Formal Clearance

The formal clearance process is similar to the informal clearance process. The main distinguishing features are as follows:

- The ACCC must determine an application for formal clearance within 40 business days (although there is provision for this time to be extended by a further 20 days by the ACCC).
• The application form is prescribed under the Trade Practices Act and sets out a series of questions that require detailed responses, including the provision of evidence in support of contentions made.

• The process is more transparent with the application and submissions made available on a public register on the ACCC’s website (subject to any particular confidentiality issues).

• There is a filing fee of AUD20,000.

• Unlike an informal clearance, if formal clearance is granted, parties are immune from actions under Section 50 of the Trade Practices Act.

At the time of writing, the formal process has yet to be used by any merger applicant.

**Authorization**

The authorization process is a means by which the Tribunal can authorize a merger that would otherwise breach the Trade Practices Act where the public benefit of the merger is such that it should be allowed. Once authorization is granted, neither the ACCC nor any other party may take action under the Trade Practices Act in respect of the merger.

The current filing fee for authorization is AUD25,000. Merger parties must make an application for authorization directly to the Tribunal. The Tribunal is required to issue a determination on an authorization application within three months. If no decision is made within this period, the Tribunal is taken to have refused the application.

In determining what amounts to a benefit to the public, the Tribunal must take into account the specific benefits which the Trade Practices Act deems to benefit the public. The onus is on the applicant to satisfy the Tribunal that the public benefits of the merger or acquisition outweigh any competitive effects.
Except as noted below, Australia has no exchange controls relevant to M&A transactions and no longer requires tax clearance certificates. The Australian government has implemented resolutions of the United Nations Security Council in imposing sanctions against certain nations and entities, including the Taliban, Al-Qaida and officials of the previous government of Iraq. Accordingly, exchange controls have been imposed in relation to certain transactions with these groups.

Securities Law Issues

The general rule under Australian securities laws is that a person may not offer securities for issue or (in more limited circumstances) sale without lodging a disclosure document (e.g., a prospectus) with ASIC.

There are a number of exceptions to the general rule. The most relevant in M&A transactions are:

- with respect to the sale of securities, where the seller does not control the entity that issued the shares that are subject to the offer;
- an offer for securities where the total price payable by the offeree exceeds AUD500,000;
- offers of securities to certain sophisticated investors; and
- offers of securities made as consideration for an offer to acquire securities under a takeover bid and accompanied by a bidder’s statement.
Financial Assistance for Share Acquisition

Section 260A of the Corporations Act prohibits an Australian company from financially assisting in the acquisition of its own shares or the shares of its parent company (including a parent which is not an Australian company) if the assistance would materially prejudice the interests of the company, shareholders and/or creditors. This prohibition does not apply if the proposed financial assistance has been approved by shareholders of the Australian company and if ASIC has been notified and has not raised any objections.

Section 260A should be considered if the target company is to do or agree to do any act to assist the acquisition. This includes funding any part of the purchase consideration or agreeing to provide such funds in the future, or securing any facility for payment.

Approval Time

The approval process typically takes four weeks, sometimes less.

Specific Industry Regulation

Legislation specific to certain industries may limit acquisitions. For example, the Broadcasting Services Act 1992 regulates ownership of the Australian media.
In share or asset acquisitions, certain consents and approvals may be required before the transaction can be completed. Below are some common examples.

Restrictions in the Constitution or Shareholders’ Agreement

In an acquisition of some but not all of the shares of a company, the consent of other shareholders may be required to waive any existing rights of first refusal that they may have under the constitution of the target. In an acquisition of assets, the target’s constitution should be checked to see if the disposal of assets requires the consent of all or some of its shareholders. The same considerations apply to any shareholders’ agreement entered into by the shareholders of the target that may have provisions restricting the disposal of shares or assets in the target.

Third Party Consents

Contractual consents may be required from third parties such as creditors, landlords, equipment lessors, debenture holders, mortgagees and other contracting parties as a result of the transfer of assets (in the case of an asset acquisition) or the change of control (in the case of a share acquisition).

Licenses

Investors should not underestimate the procedures for transferring licenses or obtaining new licenses where there is an acquisition of assets.
The primary taxes that impact on mergers and acquisitions in Australia are as follows:

- Income tax (which includes net capital gains in the tax base)
- GST, which is similar to, but not the same as, European and Canadian value added taxes
- Stamp duty, a transaction tax

Income tax and GST are imposed at the federal level. Stamp duty is imposed at a state or territory level and the rules vary.

**Income Tax**

Australian resident companies (both public and private) are liable to corporation tax of 30% on their worldwide income. Broadly, tax is paid in quarterly installments with a company tax return filed with the Australian Taxation Office. Non-resident companies are only liable to corporate tax of 30% on Australian sources of income.

**Residency**

A company is an Australian resident if it is incorporated in Australia or, if incorporated outside Australia, it carries on business in Australia and has:

- its central management and control in Australia; or
- its voting power controlled by Australian resident shareholders.
Calculation of Taxable Income

In determining taxable income, companies are permitted to deduct from their assessable income allowable deductions (e.g., ordinary business deductions, depreciation and any special incentive deductions).

The assessable income of a company includes its ordinary income and certain items of statutory income including, but not limited to, capital gains.

Ordinary business deductions include expenses incurred in gaining or producing a company’s assessable income or expenses necessarily incurred in carrying on the business for the purpose of gaining or producing assessable income. In practice, this will include recurrent operating expenses, certain business-related capital expenditures associated with the commencement or cessation of a business (deductible over five years) and interest costs.

The capital allowances regime in Australia generally allows taxpayers a deduction for tangible and certain intangible assets used, or installed ready for use, by a company (based on an effective life). Tax depreciation is not permitted on goodwill. If depreciable property is disposed of, recouped depreciation is taxed as ordinary income.

Capital Gains Tax

In relation to capital gains, there are various rollovers and reliefs that are available. In particular, relief is generally available for scrip-for-scrip takeovers, for qualifying demergers and capital gains made on the disposal of active foreign companies.

With respect to non-residents, the general position is that non-residents are taxed on income that has an Australian source and capital gains arising in respect of assets that are taxable Australian property.

Assets that are taxable Australian property include:

- land in Australia (including leasehold interests);
- mining, quarrying or prospecting rights if the material or minerals are in Australia;
- capital gains tax assets used in carrying on a business in Australia through a permanent establishment;
• a membership interest of 10% or more in an entity (tested at the time of disposal or throughout a 12-month period that began within the 24 months before the time of disposal) where the assets of the entity directly or indirectly principally (i.e., more than 50%) consist of real property in Australia (i.e., land in Australia, and mining, quarrying or prospecting rights if the material or minerals are situated in Australia); and
• options or rights to acquire any of the assets referred to above.

Taxation of Corporate Groups

Australia’s consolidation rules allow members of a wholly owned group (including non-corporate vehicles) to choose to be taxed for income tax purposes as a single entity (i.e., the “head company” of the group is subject to Australian income tax). Each of the subsidiary members are treated as part of the “head company” rather than as separate income tax entities. A number of consequences arise as a result of forming a tax consolidated group including, but not limited to:

• a single tax return is filed;
• the “head company” is responsible for the tax liabilities of the consolidated group;
• intra-group transactions are ignored for Australian income tax purposes; and
• special rules apply to the tax cost base of assets and the utilization of losses.

Transfer of Losses

Broadly, losses can only be “transferred” to resident companies within a tax consolidated group. If a corporate group has not elected to consolidate, prior-year losses can only be utilized in subsequent years by the entity that has generated the losses, subject to certain loss-utilization rules being satisfied, namely the continuity of ownership test or the same business test.

Debt/Equity Rules

All company financing interests must be characterized under special debt/equity rules that are intended to classify an interest based on the substance of the arrangement. In broad terms, returns made on a debt interest will be in the nature of interest and will be deductible to the borrower company. Certain financing interests that do not satisfy the debt test may be characterized as an
equity interest. Returns made on an equity interest are treated as dividends. Dividends are not deductible to the company paying the dividend but are potentially frankable.

**Thin Capitalization Rules**

Australia has comprehensive thin capitalization rules. The thin capitalization rules operate to deny all or part of a debt deduction where the deduction sought exceeds certain gearing levels. For example, if the corporation is directly or indirectly foreign controlled, then the thin capitalization rules will apply. A 50% shareholding is taken to be control but a corporation can be foreign controlled with a lesser level of foreign ownership.

The permissible gearing levels are determined by a safe harbor ratio. The safe harbor ratio is roughly equivalent to 3:1 debt to equity (but subject to a number of complex adjustments). The government has recently indicated that it may seek to tighten the safe harbor ratio to bring Australia’s thin capitalization regime closer in line with that of similar economies.

A greater level of debt is possible for:
- banks and certain other financial entities; and
- where an alternative test, the arm’s length test, is satisfied.

The thin capitalization rules are subject to a de minimus rule: if the total interest incurred by the entity and its associates does not exceed AUD250,000 for the year, or where the foreign assets of the entity and its associates represent 10% or less of their combined Australian and foreign assets, then the restrictions do not apply.

**Double Taxation Agreements**

Australia has entered into comprehensive Double Taxation Agreements (“DTAs”) with more than 40 countries. The DTAs broadly seek to prevent double taxation by allocating taxing rights to each relevant jurisdiction in respect of different forms of income.

**Repatriation**

Australia imposes withholding taxes on the remittance of interest, dividends and royalties, and other certain payments to non-residents.
Dividends

Dividends paid by a resident company to a non-resident shareholder are generally subject to dividend withholding tax of 30%. However, the rate of withholding tax may be reduced by an applicable double tax agreement (typically to 15%, but lower rates may apply under the more recently negotiated agreements). No withholding tax applies to franked dividends.

By way of background, an unfranked dividend is essentially a dividend paid out of profits of the resident company in which no underlying Australian corporate tax has been paid. A fully franked dividend is a dividend paid out of profits of the resident company from which underlying Australian corporate tax has been paid.

Interest

Interest withholding tax is payable under domestic law at 10% of the gross amount of interest payable unless an exemption (such as the exemption for interest on certain widely offered debentures) is available. This is generally the same regardless of whether a treaty applies, although a nil rate applies in some of the more recently negotiated treaties (e.g., Finland, France, Japan, Norway, South Africa, UK and US) for interest derived by certain financial institutions.

Royalties

The general rate of royalty of withholding tax is 30%. However, this will generally be reduced to 10% if the recipient of the royalty is a resident of a country with which Australia has a DTA. A lower rate applies under some of the recently renegotiated treaties (e.g., Finland, Norway, UK and US).

Managed Investment Trust Fund Payments

Fund payments from a managed investment trust to a non-resident (not operating from an Australian permanent establishment) located in an information exchange country must withhold tax at 15% for payments made after 1 July 2012. For recipients in non-information exchange countries, tax is withheld at 30%.
Transfer Pricing

Australia has comprehensive transfer pricing rules. Under these rules, pricing for international dealings between related parties should reflect an arm’s length return for the activities carried out in Australia, the Australian assets used (whether sold, lent or licensed) and the risks assumed in carrying out these activities.

Taxation of Financial Arrangements (“TOFA”)

The TOFA provisions deal with the tax treatment of gains and losses from “financial arrangements.” Those measures apply to new financial arrangements that a taxpayer “starts to have” on or after 1 July 2010, unless a taxpayer has made an election to bring its existing financial arrangements into the TOFA regime.

TOFA applies mandatorily to certain entities. Where TOFA does not apply mandatorily, a taxpayer may make an irrevocable election to have Division 230 apply to their financial arrangements.

GST

GST is currently imposed at a rate of 10% on taxable supplies. The tax is paid by the supplier but would generally be recovered under contract from a recipient of that supply. The tax applies to residents and non-residents alike if the following threshold requirements are satisfied:

- There is a supply for consideration.
- That supply is made in the course or furtherance of an enterprise carried on by the supplier.
- The supply is connected with Australia.
- The supplier is registered or required to be registered.

To recoup GST charged in addition to the purchase price on an acquisition of assets and third party services (e.g., GST on professional fees), the recipient must, among other requirements, be registered for GST purposes. If registered, the recipient should be entitled to claim back the GST paid to the supplier as input tax credits from the ATO. Where there is a share acquisition, GST costs (e.g., included in advisor’s fees) may be unrecoverable.

GST may not apply in certain circumstances. For example, the supply of a business by way of a sale of assets may be a supply of a “going concern” that is GST-free,
provided certain requirements are met. In broad terms, a going concern is an operating enterprise that the vendor carries on until the date of sale when the buyer is provided with all things necessary for its continued operation. The purpose of the going concern exemption is to provide cash flow relief since the buyer does not need to pay the GST to the supplier and subsequently claim an input tax credit. In addition, the supplier can recover any GST it has paid on acquisitions it has made in order to make the supply of the going concern (such as legal costs).

GST may also not apply to transactions which are “input taxed,” such as the supply of shares. In those supplies, no GST is payable on the supply. However, both the supplier and recipient may not be able to recover GST paid on third party services relating to the input taxed supply, although reduced input tax credits may be available for the cost of some things, which will minimize the impact of the lost GST.

Stamp Duty

An acquisition of assets may be subject to stamp duty depending on the Australian state or territory where the relevant assets are located or taken to be located. The stamp duty rates and forms of dutiable property vary from jurisdiction to jurisdiction. Where stamp duty is payable in respect of an asset acquired, the duty is calculated on the higher of the consideration payable and the unencumbered market value of the dutiable property being transferred.

All states and territories impose duty on the acquisition of land interests. Duty is levied in certain states and territories on the acquisition of most business assets, including plant and equipment, inventories/stock-in-trade, trade receivables and also intangible property (e.g., goodwill and intellectual property). Each Australian state and territory has its own stamp duty legislation and stamp duty is levied and administered by different state revenue authorities.

Except where a private company is a landholder or land rich (in which case duty is paid at transfer duty rates on the value of the land as if the land had been purchased directly at its unencumbered market value), share transfer duty is imposed on an acquisition of shares in a private company located or taken to be located in New South Wales, the Australian Capital Territory or South Australia. The remaining Australian states and territory have abolished this duty. The current rate of duty is 0.6% calculated on the higher of the consideration payable and the unencumbered market value of the shares being transferred. The location of shares in a company is determined by reference to the state or territory of registration of that company.
Dealings in quoted shares in listed companies are generally exempt from duty (with the exception of takeovers of landholder companies which may be taxed in a number of jurisdictions). Similar rules apply to stapled securities that are quoted in a recognized stock exchange for the purposes of the relevant stamp duty legislation.

Relief from duty is available for a qualifying corporate reconstruction in most states and territories (with the exception of Tasmania). The rules for obtaining such relief vary from jurisdiction to jurisdiction and there are certain conditions that are attached to the grant of such relief from duty. Among other things, it generally requires the parties seeking relief to have been “associated” companies both prior to the transfer and after the transfer for between one year and three years.

Duty is also imposed on amounts secured under mortgages, charges and other securities in New South Wales. The effective rate of duty in New South Wales is 0.4%. Mortgage duty will be abolished in New South Wales from 1 July 2012. The remaining jurisdictions no longer charge mortgage duty.

**International Dealings Schedule and Reportable Tax Positions**

From 1 July 2012, the Australian Taxation Office requires taxpayers to lodge an ‘International Dealings Schedule’ (“IDS”) where a certain quantum of international related party transactions exist or the thin capitalization regime applies to the taxpayer. Among other disclosures, the IDS requires disclosure of any significant restructures undertaken between Australian taxpayers and international related parties or branch operations. As the term ‘restructure’ is defined broadly, taxpayers should consider the required IDS disclosures in the event of any mergers and acquisitions activity.

As part of its 2012-2013 compliance program, the ATO has indicated that it will write to its largest taxpayers (around 170 for the 2012-2013 income year) requiring them to lodge a Reportable Tax Positions (“RTP”) schedule. This requires taxpayers to disclose certain ‘reportable positions’.

A tax position may be reportable if either:

- it is a position that is about as likely to be correct as incorrect or less likely to be correct than incorrect;
- a position in respect of which uncertainty about taxes payable or recoverable is recognized and/or disclosure in the taxpayer’s financial statements or a related party’s financial statements; or
- a reportable transaction or event.
Transfer of Employees

Share Acquisition

In a share acquisition, the buyer becomes the owner of shares in the entity that owns the assets and employs the employees in the business. The employees’ employer does not change and the existing employment contracts therefore remain in force. The buyer will assume ultimate liability for all existing employment arrangements. Employees who do not wish to remain with the employer after the share ownership has changed (and whose employment terms and conditions will not change as a result of the share purchase) must resign by giving notice in accordance with their employment contract or any applicable industrial instrument.

The buyer in a share acquisition should consider the following employment issues:

a. The existing contractual terms and conditions of employment (whether verbal or in writing)

b. The application of any awards or other industrial instruments

c. Any unusual or generous employment entitlements such as incentive payments, share options, superannuation contributions, redundancy or termination payments and any payments or benefits that are triggered as a result of the share purchase
d. The value of accrued employee entitlements that are calculated upon length of service, such as personal leave (including sick leave and carer’s leave), annual leave and long service leave; entitlements in relation to notice of termination and redundancy payments (if any)

e. Any entitlements to other forms of leave that are based on service (such as parental leave)

f. Any likely liability arising from the seller’s failure to comply with (a) and (b) and (c)

g. Any current, ongoing or recent claims against the seller brought by or on behalf of employees

h. The industrial context and history of the seller’s business including any industrial disputes and details of relevant unions active in the business

Many of the entitlements described in (d) above give rise to contingent liabilities. For instance, the buyer will only be required to make redundancy payments if the buyer at some point terminates the employment of a transferring employee by way of redundancy. Many service-related entitlements are calculated by reference to an employee’s length of service with an employer.

When a buyer takes over the business, it will be obliged to accept responsibility for ongoing employee entitlements and the employees’ period of service before and after the acquisition will not be broken despite the change in control. Therefore, it is common for the buyer to negotiate a reduction in the purchase price or obtain specific indemnities in relation to the liabilities that the buyer is agreeing to inherit (particularly in the case of outstanding accrued entitlements).

It is also important to consider that a transfer of these liabilities may have GST implications and it may be necessary to seek specialist tax advice.

Asset Acquisition

Under Australian common law, the employment of an employee cannot be transferred from one employer to another without the employee’s consent. Therefore, an asset acquisition will not give rise to an automatic transfer of employment. Rather, for the transferring employees to commence employment with the buyer, the employees’ employment with the seller must be terminated and the employees must then accept an offer of employment from the buyer. In most cases, we recommend that the seller seek the employees’ agreement to their employment with the seller ceasing avoid liabilities arising on termination of employment at the initiative of the seller (e.g., liabilities in relation to notice of termination or payment in lieu of notice, redundancy and accrued leave entitlements).
To take advantage of exemption provisions in the Fair Work Act 2009 [Cth] ("FW Act"), a seller will usually require that a buyer make offers of employment to employees on terms and conditions which are no less favorable (considered on an overall basis) than the employees’ current terms and conditions of employment with the seller. This is because when offers are made to this standard, the FW Act provides that employees who have received such offers are not entitled to redundancy payments under the FW Act (which would ordinarily be the liability of the seller).

Where an employee accepts an offer of employment with the buyer, the buyer has obligations under the FW Act to recognize prior service with the seller as continuous service with the buyer and assume liability for certain accrued employee entitlements, such as leave entitlements.

In addition, an employee who is not offered employment with the buyer or who does not accept an offer of employment with the buyer will be entitled to payment of any accrued annual leave and accrued long service leave (if long service leave is payable under state long service leave legislation). Further, the seller must consider the period of notice of termination that is required to lawfully terminate the employees’ employment. The period of notice of termination that is required is determined by referring to the employees’ contracts of employment with the seller, any applicable industrial instruments (such as awards and/or enterprise agreements) and the (FW Act).

The FW Act, provides minimum periods of notice of termination applicable to an employee based on the continuous service of the employee, calculated as follows:

<table>
<thead>
<tr>
<th>Employee’s Period of Continuous Service with the Employer</th>
<th>Period of Notice</th>
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<tbody>
<tr>
<td>Not more than one year</td>
<td>At least one week</td>
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<tr>
<td>More than one year but not more than three years</td>
<td>At least two weeks</td>
</tr>
<tr>
<td>More than three years but not more than five years</td>
<td>At least three weeks</td>
</tr>
<tr>
<td>More than five years</td>
<td>At least four weeks</td>
</tr>
</tbody>
</table>

An employee aged over 45 years with at least two years continuous service is entitled to a further week’s notice of termination. The FW Act also provides that an employer may make a payment in lieu of all or part of the period of notice.
Discrimination Legislation

Federal and state anti-discrimination and equal opportunity legislation must also be considered in the context of an asset acquisition. In general, discrimination legislation provides that in making or deciding whether to make an offer of employment or terminating or deciding to terminate an employee’s employment, a (prospective) employer must not discriminate against a (prospective) employee on various prohibited grounds including sex, disability, race, parental responsibilities, illness/injury and union membership. These legislative provisions should be taken into account if the buyer is permitted to select employees of the seller that it offers to employ following the asset acquisition.

Unfair Dismissal

Under the FW Act, eligible employees can bring “unfair dismissal” claims alleging that the termination of their employment is “harsh, unjust or unreasonable.” Remedies for unfair dismissal include compensation and reinstatement (which is the primary remedy). To defend an unfair dismissal claim, an employer must demonstrate that it has given the employee substantive and procedural fairness when dismissing the employee from his or her employment.

An employee is not “unfairly dismissed” if the dismissal is a case of genuine redundancy.

A genuine redundancy occurs where an employee’s job is no longer required to be performed by anyone because of changes in the operational requirements of the employer’s enterprise. However, if it is reasonable to re-deploy the employee to a position (that is, a position which the employee has the skills and experience to perform within the employer’s enterprise or the enterprise of an associated entity), the dismissal will not be a “genuine redundancy”.

Adverse action/ general protections

Under the FW Act, employees also have general protections. Under the general protection provisions, an employee can bring an “adverse action” claim alleging that the employer or a prospective employer has treated the employee adversely (for example by terminating the employee’s employment or not providing an offer of employment) because the employee has or has exercised a workplace right or because of a prohibited ground (such as the employee’s age, sex, family responsibilities, disability and union membership).

Buyers and sellers must be aware of the adverse action provisions in the FW Act when selecting employees for offers of employment or redundancies. For...
example, a buyer in an asset acquisition would breach the adverse action provisions in the FW Act if it decided to offer employment only to a select group of employees because those employees were not covered by an enterprise agreement.

**Impact of Accrued Entitlements on the Sale Price**

If employees of the seller are subsequently employed by a buyer that is an associated entity (as defined under the Corporations Act) within a period of three months, there will be a “transfer of employment” and there will be no break in the “continuous service” of the transferring employees for the purpose of assessing service based entitlements. This means that for the purposes of calculating entitlements such as notice of termination, redundancy, annual leave, personal leave, long service leave and parental leave, the employees’ continuous service with the seller will count as service with the buyer and the buyer will have statutory obligations to assume liability for certain accrued employee entitlements. The parties can agree to reduce the purchase price of the business in recognition of the fact that the buyer has assumed the accrued liabilities relating to the transferring employees following the acquisition.

If employees of the seller are subsequently employed by a buyer that is a non-associated entity, and the positions that the transferring employees assume with the buyer involves the same, or substantially the same work, the buyer can decide not to recognize the employees’ service with the seller for the purpose of calculating statutory redundancy benefits and accrued annual leave entitlements.

If the buyer decides not to recognize the employees’ service with the seller in respect of statutory redundancy benefits and annual leave, the seller must pay out redundancy and annual leave entitlements on termination of each employee’s employment (if such entitlements are owing). In that situation, it may be arguable that the buyer’s offers of employment do not meet the required standard that allows the seller to rely on the exemption to the obligation to pay statutory redundancy entitlements (i.e., the seller may not be able to avoid paying redundancy entitlements under the FW Act).

**Industrial Instruments and Transfer of Business Provisions**

Buyers should be aware of any industrial instruments that apply to employees in the seller’s business, such as modern awards, “notional agreements preserving State awards,” notional agreements preserving state enterprise agreements, other transitional instruments, enterprise agreements and workplace agreements.
Where there is a “transfer of business” (as defined in the FW Act), the buyer will be bound by the terms of any industrial instrument binding on the transferring employees and the seller immediately before the time of transfer (a “transferable industrial instrument”). The transferable industrial instrument will remain binding on the buyer in respect of the transferring employees, until terminated or replaced. Further, a transferable industrial instrument will apply to the exclusion of any other enterprise agreement or named employer award which would otherwise have covered the transferring employee on transfer.

The FW Act also provides that in certain circumstances a transferable industrial instrument may cover new employees of the buyer, if the new employees have been engaged to perform the same work as the transferring employees and the new employees are not covered by an industrial instrument (i.e., an enterprise agreement or modern award) when their employment commences.

In limited circumstances, an application can be made to Fair Work Australia for an order that a transferable industrial instrument (or part of that instrument) does not apply to transferring employees in their employment with the buyer.

Consultation Requirements
There is no requirement under the FW Act or other legislation to consult employees or trade unions about a share or asset acquisition. However, there may be obligations to consult with employees and relevant trade unions about a share or asset acquisition under an applicable industrial instrument (e.g., an award or enterprise agreement).

Other Employment-Related Issues
Other issues that should be considered in relation to a share or asset acquisition include the following:

- Post-employment restrictions (such as a non-competition restraint) that may apply to transferring employees
- The transfer of employment of foreign nationals and dealing with relevant immigration requirements
- The workers’ compensation claims history of the seller
- Occupational health and safety issues, breaches or prosecutions
• Any current or potential employment-related litigation or industrial disputes at the time of the acquisition

• Past compliance with superannuation obligations and the nature of funds to which the seller makes superannuation contributions (e.g., defined benefits fund, company funds)
Preliminary Agreement - Memorandum of Understanding/Letter of Intent

Traditionally, negotiated acquisitions begin with or include a letter of intent, which is alternatively known as a memorandum of understanding ("MOU") or heads of agreement ("HOA"). It is a useful outline of the transaction and may also serve to prevent the seller from negotiating with other parties (if a binding “no-shop” clause is included), allow the governmental approval process to begin and facilitate fundraising for the transaction.

Further, a letter of intent can define a buyer’s inspection and due diligence rights, provide for the treatment of confidential and proprietary information, and establish a schedule for completing all matters necessary to close the transaction.

The letter of intent may be expressed to be binding or non-binding, wholly or in part. Unless drafted carefully, a court may decide that the document is non-binding, even if it states that it is meant to be binding.¹

Due Diligence

In seeking to reduce the legal and commercial risks of an acquisition, a buyer has two main options. First, it may require comprehensive warranties in the sale agreement. However, this method is not adequate by itself because a breach of warranty is, in the absence of a right of indemnity, enforceable by litigation or

¹ As determined in Coal Cliff Collieries V Sijehama (1991) 24 NSWLR1.
arbitration that can be both costly and time consuming. It also depends on the creditworthiness of the seller and/or the warrantors at the time the judgment is enforced. Some liabilities may not reveal themselves until after the warranties have expired. The buyer, therefore, will usually carry out pre-contract investigations, commonly known as due diligence.

The purpose of due diligence is to gather information and identify any risks or problems associated with an acquisition and decide whether the transaction is to go ahead, is to be modified (by revising the purchase price, inserting additional warranties in the sale agreement or excluding certain assets with onerous liabilities from the acquisition) or is to be abandoned. Due diligence warranties have expired. The buyer, therefore, will usually carry out pre-contract investigations, commonly known as due diligence.

The purpose of due diligence is to gather information and identify any risks or problems associated with an acquisition and decide whether the transaction is to go ahead, is to be modified (by revising the purchase price, inserting additional warranties in the sale agreement or excluding certain assets with onerous liabilities from the acquisition) or is to be abandoned. Due diligence undertaken by lawyers should be distinguished from any commercial, financial or accounting review conducted by other persons or professional advisers.

Most acquisitions will require some form of due diligence to be conducted. The form of the acquisition will usually have an impact on the types of issues to be considered. For example, if the transaction takes the form of an asset acquisition, due diligence may focus around the transferability of those assets. Where the transaction involves a share acquisition, it will be necessary to consider the impact of change in control clauses in third party contracts.

Generally, the purpose of legal due diligence in the context of an acquisition is to assist the buyer in assessing the level and nature of legal risk in the business to be acquired and to identify any relevant issues likely to arise in the sale process that might need to be dealt with in the sale agreement. This information may influence the ultimate purchase price and other terms of the transaction documents.

Legal due diligence can take many forms. For example, searches of publicly available information may be made of the ASIC database on the shareholders and officers of the target, and of the existence of charges (security interests) over the assets of the target; of the local land office on title to real property; of the local registry of trademarks and patents on title to any intellectual property rights and the existence of registered user agreements; and of the local court system for litigation and winding-up proceedings.
In more significant acquisitions, the seller may make available an extensive data room of information to provide potential buyers and their advisers with access to the relevant documents (e.g., corporate registers, key business contracts, leases, workplace agreements and policies, insurance policies, details of disputes, information technology agreements, privacy policies, tax returns and other relevant information). Access to information can be provided via access to a physical data room or online where potential buyers and their advisers can access information from their desktops. As any information provided in the context of a sale is likely to be confidential or commercially sensitive, it is important to be aware of confidentiality issues and to establish appropriate protocols for the handling of confidential information.

In addition, the buyer may send a list of enquiries about the shares or assets to be acquired to the seller and request the seller to answer them. In answering such enquiries, the seller has to be careful to avoid any misrepresentation which may subsequently be relied upon by the buyer to rescind the sale agreement and claim for damages.

In recent times, vendor due diligence ("VDD") has become increasingly common in Australia in the context of competitive bid processes. VDD is effectively the same process as traditional purchaser due diligence but commissioned at the vendor’s request and cost. The end product is a report that addresses the concerns of any prospective buyer and may potentially be relied upon by the ultimate buyer and its financiers depending on the basis on which it has been prepared.

The potential advantages of conducting VDD include:

- allowing the seller to evaluate the findings and to rectify, or at least mitigate, any problem areas before the sale process begins;
- speeding up the due diligence process by providing a useful guide to the legal structure of the business and the key legal issues affecting the business;
- reducing disruption to the business as the majority of the due diligence questions should be raised by the vendor’s lawyers in preparing the VDD report, rather than a number of potential bidders’ due diligence teams;
- limiting the amount of due diligence that the purchaser is required to undertake, resulting in a reduction of time and cost to a potential purchaser of conducting due diligence, which can potentially encourage more potential buyers into the process; and
identifying any relevant issues likely to arise in the sale process that might need to be dealt with in the sale documentation. The buyer may also instruct a firm of accountants to carry out investigations into the target’s affairs and prepare an accountant’s due diligence report. In some cases, a buyer may also wish to instruct experts to value assets, such as real property, owned by the target.

Under Australian law, the following specific points are relevant to due diligence:

• As a seller may face liability for misleading disclosures under Section 1041E or 1041H of the Corporations Act or Section 52 of the Trade Practices Act, it should conduct an internal due diligence review to ensure that a potential buyer does not receive incorrect information.

• Usually, a seller has no positive duty to disclose information to a potential buyer. However, if there is a reasonable expectation of disclosure, then a seller may face liability for a failure to disclose.2

• For share acquisitions (particularly for listed companies), insider trading laws are relevant. A seller and the target company are prohibited from providing material non-public, price-sensitive information to a potential buyer, and a potential buyer in possession of such information cannot acquire the shares.

• A potential acquirer of shares in a listed company may draw some comfort from the obligation upon the listed company to keep the market fully informed and to publicly release price-sensitive information immediately.

Documentation and Agreements

In a formal takeover, both the bidder and the target company are obliged to prepare statutory documents. In a negotiated acquisition, it is usual for the seller’s lawyers to prepare the first draft of the share purchase agreement or asset purchase agreement (the “Agreement”). The commentary below is relevant to a negotiated acquisition.

Where an acquisition occurs by way of subscription for new shares (for tax, capital increases or other reasons), a subscription agreement will usually be drafted by the target company’s lawyers.

Agreements must be carefully tailored to the particular needs of the parties. No standard Agreement can be suitable in its entirety for all negotiated transactions. In negotiating the Agreement, the parties will usually need to address the following issues:

Parties to the Agreement

In a share acquisition, the sellers are the shareholders of the target. In an asset acquisition, the owner of the assets is the seller. The parties will need to consider whether the obligations of the seller(s) or the buyer should be guaranteed by a third party. If the parties agree to such an arrangement, the third party will join as a party to the agreement as the guarantor. Persons or companies related to the sellers, such as the ultimate shareholder or substantial shareholders of a corporate seller, may be included in the Agreement as warrantors.

The warrantors will give covenants and undertakings to the buyers either on their own or jointly and severally with the sellers.

The Shares or Assets to be Acquired

In an asset acquisition, the Agreement should clearly identify the assets to be acquired and exclude those to be retained by the seller. In a share acquisition, the parties will decide whether the buyer will acquire all the issued shares in the target. If so, the Agreement usually provides that the buyer will not be obliged to complete the purchase of any of the shares unless the purchase of all the shares is completed simultaneously. Where only some of the issued shares are to be acquired, the Agreement will provide that the sellers will procure the holders of the remaining shares to waive any pre-emption rights they may have under the constitution of the target. The parties would also need to consider entering into a shareholders’ agreement with the holders of the remaining shares.

The Purchase Price and the Medium of Payment

The purchase price will be fixed at a level that reflects not just the value of the shares or assets to be acquired but other terms and conditions of the Agreement, such as whether the seller is to give extensive representations, warranties and undertakings or is to be restricted in its activities for a fixed period after completion. The parties will also need to agree upon the medium of payment, i.e., whether it should be a cash payment, a share exchange, a combination of both cash and share exchange, or other valuable consideration.

Adjustments to the Purchase Price

A formula may be inserted to adjust the purchase price based on the target’s net assets and net profits as at completion or on future profits or losses incurred after completion. In the latter case, a seller would be concerned to place certain restrictions on the buyer in relation to the conduct of the business post-completion, in particular to ensure that the buyer carries on business in the normal way.
Warranties and Indemnities

The warranties and indemnities to be given by the sellers and/or the warrantors to the buyer constitute an important part of the Agreement and are often the subject of intense negotiations between the parties. This will be discussed in the next section.

Other Provisions

The Agreement will also usually address other issues. These issues include the pre-completion rights and duties of the parties, such as imposing confidentiality requirements on the buyer; outlining the buyer’s rights to access information and restricting the seller’s right to dispose of assets in the target by way of dividends; post-completion rights and duties of the parties, such as non-competition by the seller and the provision of mutual transition assistance; the extent to which the parties will be entitled to damages in the event that the Agreement is not completed; the governing law of the Agreement; and dispute resolution methods.

Representations and Warranties

No investigation, however thorough, is likely to be able to reveal all hidden liabilities and adverse claims against the company or the assets to be acquired. In practice, time constraints, confidentiality requirements and other factors may limit the scope of any investigation. Accordingly, buyers almost invariably wish to protect themselves further by requiring the sellers and/or the warrantors to give warranties on the assets or the company to be acquired.

In a share acquisition, the warranties will generally cover the target’s accounts, taxation, corporate matters, title to assets, trading, properties, intellectual property rights, plant and equipment, stock and work in progress, vehicles, insurances, goodwill, employment matters, environmental matters, banking and finance, regulatory compliance, litigation and the accuracy and completeness of information provided by the sellers and/or the warrantors.

In an acquisition of assets, the warranties should be less extensive as they should concentrate on what is relevant in relation to the business being acquired. They will generally include ownership and condition of assets, accounts of the business, trading activities, employees and other specific issues regarding the business to be transferred.

In negotiating the terms of the warranties, the parties will need to reach agreement on the extent to which the warranties will be qualified by references to knowledge and materiality, the duration of the warranties, the existence of a
threshold under which the sellers and/or the warrantors will not be liable or a ceiling that is the limit of the sellers’ and/or the warrantors’ liability, and the basis on which damages for breach of warranties are calculated. This may result in vigorous negotiations among the parties involved.

The seller may seek to qualify the warranties contained in the Agreement by issuing a disclosure letter or schedule to the Agreement that specifies exceptions to the warranties and/or lists the relevant information about the business provided to the buyer for due diligence purposes. The disclosure letter will operate to exempt the sellers and/or the warrantors from liability in regard to the specific disclosed matters.

In addition to any warranties, the Agreement may contain indemnities in relation to certain matters where the sellers and/or the warrantors are liable notwithstanding that the buyer has knowledge of them. Such indemnities will generally cover taxation but may also be extended to other matters as agreed upon by the parties, such as environmental problems and other disclosed but unascertained liabilities.

Completion

Completion of the Agreement effects the acquisition by the buyer of a beneficial interest in the shares or assets being transferred. Usually, the purchase price is paid on completion.

In a share acquisition, it is likely that the existing directors and auditors of the target will resign and be replaced by new directors and auditors nominated by the buyer. Authorities to the banks will be revoked and new authorities will be given to persons nominated by the buyer to operate the target’s bank accounts.

The Agreement will provide that, at completion, the seller will deliver to the buyer the relevant documents relating to such registrations, appointments and revocation of authorities as well as other title documents, and documents necessary for the buyer to obtain legal title to the shares or assets acquired. If some of the directors are to be retained and their terms of service are to be revised, the Agreement will also provide that new service agreements will be entered into between the target and those directors.
Acquisition of a Substantial Shareholding Insider Trading

Under the Corporations Act, subject to a number of defenses, a person commits the offense of insider trading if that person is in possession of material non-public, price-sensitive information in relation to the price or value of securities and either:

- trades in, agrees to trade in, or procures another person to trade in the relevant securities; or
- where the securities are listed on a stock exchange, communicates the information to another person and knows or ought to know that the person will or is likely to deal in the relevant securities.

Persons convicted of insider trading can face imprisonment, among other penalties.

The concepts surrounding the insider trading prohibitions are nebulous and so, as a general rule, we recommend that legal advice is sought before engaging in the relevant conduct if there is any doubt as to whether the prohibitions may apply.
Takeovers

The Corporations Act prohibits a person from acquiring a relevant interest in issued voting shares in a publicly listed company\(^3\) if, because of the transaction, either that person’s or someone else’s voting power in the target increases:

- from below 20% to more than 20%; or
- from a starting point that is above 20% and below 90%, unless the acquisition is made under one of the permitted exceptions (discussed below).

The prohibition also applies to voting shares in an unlisted Australian company with more than 50 shareholders and voting interests in a listed managed investment scheme (such as a listed unit trust): sections 604(1) and 606(1), Corporations Act.

The key concept in determining whether an acquisition breaches the 20% limit is the “voting power” that results from the acquisition. Voting power is a term that aggregates the “relevant interests” held by a person (a term which widely draws in all direct and indirect holdings), together with the relevant interests of the person’s “associates.”

Acquisitions of voting shares can be made above the 20% limit under the Corporations Act in a number of ways,\(^4\) including:

- under an off-market takeover bid for either all or a fixed proportion of each shareholder’s shares in the target;
- under an unconditional on-market takeover bid for all of the shares in a target;
- acquisitions made with the prior approval of target company shareholders in general meeting;
- “creeping” acquisitions of up to 3% of the target’s shares every six months;
- an acquisition under a pro-rata rights issue;
- certain acquisitions by underwriters; and
- certain downstream acquisitions that are deemed to result from upstream takeovers.

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3 The prohibition also applies to voting shares in an unlisted Australian company with more than 50 shareholders and voting interests in a listed managed investment scheme (such as a unit trust): sections 604(1) and 606(1), Corporations Act.

4 See section 611 of the Corporations Act for a full list of permitted exceptions.
Takeover Regulation

Supervision of compliance with the Corporations Act has been entrusted to ASIC and the Takeovers Panel (the “Panel”). ASIC may exempt a person from the application of a provision of the Corporations Act or amend the Corporations Act in respect of its application in a particular case. Thus, relief may be obtained from technical sections of the Corporations Act that may, in some instances, produce results unintended by the legislature.

The Panel is staffed by industry practitioners and experts in the field. It was established to act as the main forum for the resolution of disputes stemming from changes in control or relating to the acquisition of substantial interests in a company. The Panel has significant powers, including the power to:

- review the merits of ASIC decisions to modify the takeover rules;
- declare circumstances of an acquisition to be unacceptable and make concomitant orders, including that a takeover bid should cease or proceed in altered form; and
- formulate rules to clarify and supplement the takeover provisions.

Anyone affected by the circumstances of the acquisition or an ASIC decision may apply to the Panel for a declaration, order or review. Contravention of the Panel’s orders is an offense.

Takeover Documents

There are three principal documents that need to be prepared as part of the takeover process.

**Bidder’s Statement** - Whether the offer is a written one to shareholders in an off-market bid or is announced to the ASX in an on-market bid, the bidder must prepare a detailed statement that addresses a range of statutory questions. The statement must provide information on the offeror and the offer, such as, the sources of finance for the offer price and the offeror’s intentions with regard to the future conduct of the target’s business. The general requirement is that the statement must contain any information known to the bidder which is material to an offeree in deciding to accept or reject the bid. The statement is provided to ASIC, the ASX, the target and the target’s shareholders.

**Target Statement** - Upon receiving a bidder’s statement, the directors of the target must respond to their shareholders with a target statement. This statement must also address a range of statutory questions, most importantly, whether the directors recommend that shareholders accept or reject the takeover offer. The same
general information requirement remains: the target statement must contain all information that shareholders and their advisers would reasonably require to make an informed assessment of the bid. Copies of the statement must also be provided to the bidder, ASIC and the ASX.

**Independent Expert’s Report** - An expert’s report must be commissioned by the target and provided to all shareholders with the target’s statement in circumstances where the bidder and target have common directors or the bidder commences its takeover with voting power in the target of 30% or more. The object of this report is to state whether, in the expert’s opinion, the takeover offer is fair and reasonable to the target’s shareholders. Reasons for this opinion must also be provided.

For further information regarding the takeover regime in Australia, including a detailed description of the types of takeover bids and bid procedure, please refer to Baker & McKenzie’s *Public Companies Takeovers Guide (Australia)*.

**Disclosures by Public Companies**

**Continuous Disclosure Obligations**

Publicly listed companies are required to disclose to the ASX information concerning the company that a reasonable person would expect to have a material effect on the price or value of the company’s securities as soon as the company is or becomes aware of the information (ASX Listing Rule 3.1).

A company will be deemed to be “aware” of information if a director or executive officer has, or ought reasonably to have, come into possession of the information in the course of the performance of their duties as a director or executive officer of the company (ASX Listing Rule 19.12). Hence, publicly listed companies should establish policies and procedures to ensure that price sensitive information is passed up the chain to directors and executive officers. It will not be sufficient for directors and executives to claim they “didn’t know” about the relevant event or development. These policies and procedures should address, among other things:

- internal notification and decision-making concerning disclosure obligations;
- the roles and responsibilities of directors, officers and employees in the disclosure context; and
- promoting understanding of and monitoring compliance with disclosure obligations. See also ASX Corporate Governance Principles and Recommendations 5.1.
Confidentiality Carve-Out

Publicly listed companies are not required to disclose price sensitive information if:

- a reasonable person would not expect the information to be disclosed;
- the information is confidential and the ASX has not formed the view that the information has ceased to be confidential; and

one or more of the following applies:

- it would be a breach of a law to disclose the information;
- the information concerns an incomplete proposal or negotiation;
- the information comprises matters of supposition or is insufficiently definite to warrant disclosure;
- the information is generated for internal management purposes; or
- the information is a trade secret (ASX Listing rule 3.1A).

All three limbs set out above must be satisfied for the exemption to apply. If any one limb ceases to be satisfied, the relevant information must be disclosed. The confidentiality carve-out highlights the importance of entering into confidentiality agreements when negotiating sensitive commercial deals, including mergers and acquisitions.

Examples of Information Requiring Disclosure

It can be notoriously difficult to determine when information requires disclosure and it is often a matter of fine judgment as to what precisely should be disclosed. As a general rule, and particularly given the consequences for failing to comply with the continuous disclosure rule, we recommend that publicly listed companies err on the side of caution and, if in doubt, seek legal advice.

Practical examples of events requiring disclosure are set out in the ASX Listing Rules themselves and include a transaction for which the consideration payable or receivable is a significant proportion of the written down value of a company’s consolidated assets (as a general rule, 5% or more will be “significant”).

Further, specific disclosures are required to be made by listed entities under the Corporations Act and the ASX Listing Rules, including notices of a change in a substantial shareholding. A person will be a substantial holder if it has voting power of at least 5% in the listed body.
Consequences of Different Levels of Investment

Subject to the relevant company’s constitution, certain shareholding levels usually entail the consequences set out below.

<table>
<thead>
<tr>
<th>Level</th>
<th>Consequences</th>
</tr>
</thead>
<tbody>
<tr>
<td>5%</td>
<td>Where the company is a listed company, notice of the acquisition or disposal, or a change in that interest, must be given to the company and ASX. Members of a company holding 5% or more of the shares may requisition the board to convene a general meeting. They may also demand that votes at a general meeting be cast by way of a poll.</td>
</tr>
<tr>
<td>10%</td>
<td>A member who holds at least 10% of the shares of a company can block the compulsory acquisition of all shares in the company.</td>
</tr>
<tr>
<td>15%</td>
<td>A foreign investor wishing to acquire 15% or more of the shares of a company with gross assets of AUD248 million or above (or AUD1,078 million or above if the ultimate investor is a US entity and satisfies the requirements of the Free Trade Agreement between Australia and the US) must comply with Australian foreign investment law.</td>
</tr>
<tr>
<td>Level</td>
<td>Consequences</td>
</tr>
<tr>
<td>---------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>20%</td>
<td>A person wishing to acquire 20% or more of the voting shares of a listed company or an unlisted company with 50 or more shareholders must comply with the takeover provisions of the Corporations Act.</td>
</tr>
<tr>
<td>More than 25%</td>
<td>Holders of more than 25% of the voting rights may block those actions that require the authority of a special resolution of shareholders (e.g., winding up the company, change of constitution, change in capital and change of name). This is known as negative control.</td>
</tr>
<tr>
<td>30%</td>
<td>If a bidder has a 30% shareholding in a listed target at the time a takeover bid is made, it is considered to be an associate of the target for the purpose of the takeover disclosure regulations. The principal effect of this is that an independent expert’s report must be commissioned and sent to shareholders along with the target’s response to the bid.</td>
</tr>
</tbody>
</table>
| More than 50% | A majority shareholding provides the ability to appoint and remove directors of the company at a general meeting.  
A holding company may be liable for the debts that its subsidiary incurs while insolvent.  
A subsidiary cannot purchase, or (in some circumstances) financially assist the purchase of, shares in its holding company.  
When there is a likely change of control in a listed company, the ASX may suspend trading in the shares unless investors have been adequately informed of the effect of the change. |
<p>| 75%     | A 75% shareholder may pass any special resolution, such as for a change to the company’s constitution, so long as it is not oppressive to minority shareholders. |</p>
<table>
<thead>
<tr>
<th>Level</th>
<th>Consequences</th>
</tr>
</thead>
<tbody>
<tr>
<td>90%</td>
<td>An offeror that has received acceptance for 90% or more of the shares following a takeover bid may acquire the remaining shares compulsorily. In some Australian states, relief from stamp duty is available on the transfer of assets within a 90% owned group of companies.</td>
</tr>
<tr>
<td>100%</td>
<td>A wholly-owned Australian resident company can be tax consolidated within a corporate group to operate as a single entity for income tax purposes. A wholly-owned subsidiary may be able to obtain relief from the requirements under the Corporations Act as to the undertaking of an audit and the preparation of accounts and statutory reports.</td>
</tr>
</tbody>
</table>
Summary of Australian Foreign Investment Regulation Under the Foreign Acquisition Act (other than for US Investors)

<table>
<thead>
<tr>
<th>Form of Acquisition</th>
<th>Prior Approval by Australian Treasurer Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct share acquisition of a “substantial interest” in an Australian company^6^</td>
<td>Gross assets of target valued at AUD248 million or more</td>
</tr>
<tr>
<td>Asset acquisition of a “substantial interest” in an Australian company</td>
<td>Gross assets of target valued at AUD248 million or more</td>
</tr>
<tr>
<td>Indirect share acquisition of a “substantial interest” in an Australian company</td>
<td>Gross assets of target valued at AUD248 million or more</td>
</tr>
<tr>
<td>Asset or share acquisition of an offshore company that has Australian subsidiaries</td>
<td>Gross assets of Australian subsidiary valued at AUD248 million or more</td>
</tr>
<tr>
<td>or assets</td>
<td></td>
</tr>
<tr>
<td>Form of Acquisition</td>
<td>Prior Approval by Australian Treasurer Required</td>
</tr>
<tr>
<td>-------------------------------------</td>
<td>---------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Acquisition of urban land</td>
<td>Heritage listed, developed, non-residential commercial real estate valued at AUD5 million or more</td>
</tr>
<tr>
<td></td>
<td>Developed, non-residential commercial real estate valued at AUD54 million or more;</td>
</tr>
<tr>
<td></td>
<td>Leases where the likely term of the lease is more than five years</td>
</tr>
<tr>
<td></td>
<td>All accommodation facilities</td>
</tr>
<tr>
<td></td>
<td>All vacant urban real estate</td>
</tr>
<tr>
<td></td>
<td>All residential real estate</td>
</tr>
</tbody>
</table>

5 For a share acquisition (direct or indirect) of a “substantial interest,” closing of the purchase agreement must be conditional on the expiry of a 40-day notice period or receipt of a letter of no objection from the Treasurer (whichever is earlier). A “substantial interest” will also arise where the acquirer is in the position to control 15% or more or 40% or more of the actual or potential voting power of the target.

6 For any acquisition of less than 15% of the shares of the target with total assets of AUD248 million or more, where the target already is foreign controlled, the Treasurer has power to prohibit the acquisition if it is contrary to the national interest.

7 For an asset acquisition, unless the acquirer receives a no-objection letter or a 30-day notice period expires, the Treasurer has power to prohibit the acquisition.

8 Leases over commercial real estate are subject to the AUD54 million threshold or a AUD5 million threshold in the case of heritage listed commercial real estate.

9 Acquisitions of developed residential real estate are not usually approved.
CHINA
DISCLAIMER

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Investment Overview

Since the People’s Republic of China ("PRC") joined the World Trade Organization ("WTO") in 2001, the PRC foreign investment regime has evolved considerably. Developments in mergers and acquisitions ("M&A") by foreign investors are particularly prominent, including the Ministry of Commerce’s ("MOFCOM") further delegation of authority to approve foreign investment projects to its local counterparts; the introduction of partnership as an investment vehicle for foreign investors; and tightened scrutiny of offshore transaction from the PRC tax, exchange control, merger control and national security perspectives.

While China is currently widely regarded as one of the most promising jurisdictions in the world for foreign investment, there remain various legal hurdles and practical difficulties for international investors tapping into the potential of the Chinese market.

Lack of transparency and bureaucracy are continuing concerns, complicated by China’s continuing reluctance to allow foreign control of or even participation in key industries or well-known brands.

Special Notes

This chapter discusses the topics it covers primarily from a foreign buyer’s point of view. It does not seek to cover issues in M&A initiated by domestic PRC companies and touches only marginally on issues to be considered and resolved primarily by sellers.

For the purposes of this chapter, the terms "PRC" or "China" do not include Hong Kong, Macau or Taiwan.
Forms of Establishment

Traditionally, foreign investors usually establish a presence in the PRC via one or more of the following legal forms:

- Representative Office ("Rep Office")
- Sino-Foreign Joint Venture ("JV")
- Wholly Foreign-Owned Enterprise ("WFOE")
- Foreign-Invested Joint Stock Limited Company ("FISC")

The latest option, available since 2010, is the foreign-invested partnership ("FIP"). The more flexible FIP form is starting to replace the foreign-invested venture capital enterprise (a form of a PRC vehicle used by some international investors to acquire Chinese targets), particularly with PRC investment funds aimed at foreign investors.

Rep Offices are non-legal person extensions of their foreign investors in the PRC. A JV or a WFOE takes the form of a limited liability company ("LLC") that does not issue shares but has "registered capital" and "total investment" (paid-in capital plus permitted borrowing), which are both approved by the PRC government. FISCs, currently less common in China, are share-issuing companies similar in legal form to Western-style corporations. An FIP may take the form of a limited liability partnership, which is akin to its Western-style counterparts. JVs, WFOEs, FISCs, FIPs and FIVCEs are collectively known as Foreign-Invested Enterprises ("FIEs") if the foreign shareholdings in these enterprises are 25% or greater.
These common foreign investment vehicles in China are summarized below.

**Representative Offices**

Rep Offices are popular in the PRC both as a first step into the market and as a way of maintaining a presence without committing more resources than necessary. Since it is currently impossible to set up branches in China (as discussed below), establishing a Rep Office is the least capital-intensive means for foreign investment in China.

Rep Offices allow foreign companies to do local promotional and marketing activities and local research for their products. However, they are prohibited from engaging in “direct business operations” in the PRC. Accordingly, Rep Offices may not sell products in the PRC, and Rep Office personnel may not sign contracts in the PRC on behalf of the Rep Office or issue sales invoices. Unlike an FIE, a Rep Office is not a separate legal person from its head office and the head office assumes all liabilities resulting from the Rep Office’s operations in China. In effect, Rep Offices are branches with significantly restricted scopes of permissible activities.

**Sino-Foreign Joint Ventures**

A JV is typically a non-share-issuing, limited liability company formed between one or more non-PRC entities (including Hong Kong, Macau and Taiwan entities) and one or more Chinese entities. A JV can be either an Equity Joint Venture (“EJV”) or a Cooperative Joint Venture (“CJV”), which are typically structurally similar in most respects. JVs have definite, albeit extendable, terms of operations.

JVs are popular investment vehicles either for foreign investors less familiar with investment in China that would prefer a local partner with connections to help handle local issues, or for those investing in certain industries that require the participation of a Chinese partner under the current PRC legal regime.

Most investors who establish JVs in China choose to set up EJVs. Investors typically would adopt a CJV structure if they specifically desire to adopt a non-legal person structure, need more freedom in configuring their profit distribution ratios or prefer to be able to recover their investments early under certain circumstances. (These are the main benefits of a CJV structure not available to EJVs.)
Wholly Foreign-Owned Enterprise

A WFOE is a limited liability company 100% owned by one or more foreign entities (and thus would include a joint venture between two foreign investors), although most WFOEs only have one investor. Like JVs, WFOEs have equity in the form of registered capital not divided into shares, and no shares are issued, and have definite, albeit extendable, terms of operations.

WFOEs are the most popular China investment vehicles, especially favored by foreign investors that are more familiar with investment in China. Because it is wholly foreign owned, a WFOE usually enjoys greater flexibility in management and control, and avoids the complications of dealing with Chinese partners. On the other hand, a WFOE is more stringently restricted in the types of business it may engage in, especially in certain sensitive industries.

Foreign-Invested Joint Stock Limited Companies

Unlike JVs or WFOEs, the shareholding of the investors in a FISC is in the form of issued shares, similar to Western-style corporations. A FISC is accordingly the only form of FIE that can be directly listed on PRC stock exchanges. Other forms of FIEs would have to be converted into an FISC before they could be listed. Unlike a JV or a WFOE, a FISC can be operated for an unlimited duration.

The requirements to form a FISC are much more stringent than those for JVs and WFOEs: the sponsors are subject to additional restrictions and qualifications; the foreign equity holding in a FISC must be at least 25%; a FISC must have a minimum registered capital of RMB30 million; and approval procedures to establish FISCs are generally more burdensome.

Foreign-Invested Partnership

An FIP combines the features of JVs and WFOEs, and can be partly or wholly owned by foreign investors, with the partners having limited and/or unlimited liability towards third parties.

One advantage of using an FIP is that, while a separate legal person, it is transparent for PRC tax purposes and so can offer more opportunities for tax planning. Furthermore, establishing an FIP does not require an application to MOFCOM or its local counterpart: it can be established directly by submitting the requisite documents to the competent AICs.
Foreign Contractors

In specific circumstances/industries, foreign firms may also register as foreign contractors to carry out certain projects in the PRC without first establishing any formal presence in China. However, China is gradually phasing out these arrangements. As an example, regulations have been enacted to end them in the construction industry, and foreign construction firms now must set up construction FIEs in China before they can undertake construction projects.

No Branches

Finally, as mentioned above, foreign companies currently may not establish branches in the PRC, as there are still no regulations to implement the provisions on branches of foreign companies set out in chapter 11 of the 1994 PRC Company Law. Generally, with a few exceptions including financial institutions and insurance, foreign investors looking for a presence with minimal investment establish Rep Offices, while those wishing to conduct more substantial business activities establish FIEs such as JVs or WFOEs.

Business Scopes

Under PRC law, a business entity in China (whether domestic- or foreign-invested) is allowed to engage only in those activities within the “business scope” approved by the governmental authorities and stated on its business licenses.

The Foreign Investment Catalog and Industry Restrictions

The PRC Regulations for Guiding the Direction of Foreign Investment (the “Foreign Investment Guidelines”) and the Catalogue for Guiding Foreign Investment in Industries (the “Foreign Investment Catalog”) serve as general indications of current policies governing foreign investment in various industries. These documents provide certain policy incentives or disincentives depending on whether a project is deemed “encouraged”, “permitted”, “restricted” or “prohibited”. An enterprise in the “encouraged” businesses category, for example, may be qualified for local (and generally more lenient) approval processes. An enterprise conducting “restricted” activities, on the other hand, may be subject to additional scrutiny by higher approval authorities during the establishment process and may in some cases be required to have its Chinese partner(s) control more than 50% of its equity. These documents are important guidelines that affect many aspects of merger and acquisition activities outlined in this guide. The Foreign Investment Catalog is revised every few years to embody changes in PRC foreign investment policy.
The 2011 Foreign Investment Catalog, effective January 2012, continues to restrict or prohibit foreign investment in many industries, but there are now more encouraged industries and fewer restricted and prohibited industries. Restrictions on foreign shareholdings in several industries have also been removed. The revised Catalog seeks to encourage foreign investment in high-end manufacturing, high and new technologies, modern services, new energy, energy-saving and environmentally friendly industries.

Closer Economic Partnership Arrangement

China entered into the Closer Economic Partnership Arrangement (“CEPA”) with both Hong Kong and Macau in 2003, with Supplements signed each year since, further liberalizing market access to China for qualified Hong Kong and Macau enterprises in specified sectors, on terms more favorable than those available generally through China’s WTO accession protocol. The latest Supplement was CEPA IX signed between Hong Kong and China on 29 June 2012, with market access liberalization effective 1 January 2013.

Although the CEPAs are designed primarily to benefit Hong Kong and Macau companies, they may also indirectly benefit multinational investors with significant subsidiaries already established in Hong Kong or Macau who may, through such subsidiaries, have additional options to invest in certain restricted industries in China.

Holding Companies

A Holding Company (“HC”) is a special-purpose limited liability company which allows larger companies with multiple investments in the PRC to better coordinate the operations of their different investments. An HC is typically established as a WFOE, although it can also be established as a JV. HCs can take equity stakes in other WFOEs or JVs and can provide various support services for their investee companies, including centralized purchase of raw materials and equipment; provision of after-sale services; domestic and foreign distribution of investee products; certain financing, foreign exchange and loan matters; transportation and warehousing services; and consultancy services, training and administrative support functions. An HC that qualifies as a Regional Headquarters of a Multinational can also offer logistics and distribution services and, with MOFCOM approval, operate leasing and finance leasing businesses.
Though the HC’s primary functions are to hold equity in and provide support services for investee companies, HCs have gradually been permitted to engage in a somewhat wider range of activities, including sale of imported parent company products (other than by retail sales); export of Chinese products as an agent, distributor or through establishment of an export purchasing organization; after-sales service for products that it imports; and establishment of R&D centers.

Draft regulations issued for comment in 2011 (but not yet final) would give HCs greater operational flexibility and additional business scope and make them easier to set up. HCs could be established as FISCs (not just limited liability companies as currently), and so could potentially be listed. Investors’ contributions to the HC’s registered capital could include equity in domestic companies (up to 70% of the contribution) along with cash (still at least USD30 million for all investors). HCs could provide more services to subsidiaries and investors, and engage in production. HCs with less than USD300 million registered capital could be approved provincially (rather than by central MOFCOM).
Common Types of Acquisition Transactions in the PRC

A foreign investor wishing to acquire or increase its equity in a PRC target company would commonly do so in one of the following ways:

- **Direct acquisition**, whereby the foreign investor buys all or part of the equity of the PRC target company directly or by subscription to an increase in capital of the target.

  A direct acquisition takes place in the PRC and so is subject to full PRC approval requirements, which may be time consuming and involve government discretion, i.e., the PRC authorities may withhold approval if they perceive problems with the transaction.

- **Offshore/indirect acquisition**, whereby the foreign investor may acquire or increase control of the PRC target company via the offshore purchase of equity in the target’s foreign parent(s).

  This option is available only if the PRC target company has foreign investors. An offshore acquisition takes place in the offshore company’s jurisdiction of incorporation and is generally not subject to PRC jurisdiction and review, except in certain circumstances under the PRC’s antitrust and national security review regimes (see Consents and Approvals below) and PRC tax disclosures (see Specific Tax Considerations below). In addition, if the offshore company’s ultimate shareholders are PRC nationals, certain PRC filings should have been made with the PRC foreign exchange authorities and should be reviewed during due diligence (see Exchange Control).
Asset acquisition, whereby a foreign investor, using a new FIE or an existing FIE as the acquiring vehicle, buys directly some or all of the business and assets of the PRC target company. Such asset transactions are subject to PRC jurisdiction and relevant PRC approval requirements.

Special Types of Acquisition

State-Owned Interests and Special Types of Acquisition

The Law of the People’s Republic of China on the State-owned Assets of Enterprises, passed in October 2008, was a reminder of how significant state-owned enterprises (“SOEs”) are in the Chinese national economy. It remains the Chinese government’s objective to spin off SOEs in less sensitive sectors, particularly SOEs in poor financial shape. Since early 2003, foreign investors have been allowed to acquire domestic creditors’ rights (debt) in the target SOE and thereby qualify for the opportunity to later convert such debt into equity in the company (similar to a convertible bond). The normal means of direct equity or asset acquisition applicable to regular companies outlined above will also apply, with certain special rules and restrictions. Such acquisitions could also raise other issues, such as state-asset valuations and employee resettlement issues, which are discussed below.

Mergers

Western-style mergers between two companies are possible but are rarely seen in the PRC. Current PRC statutory mechanisms recognize two means of mergers: a “merger by absorption” or a “merger by new establishment”. A merger by absorption involves one company absorbing another, after which the absorbed company is dissolved and its registered capital and assets are merged into the surviving entity. In a merger by new establishment, both pre-merger companies are dissolved and a new company is established, holding an aggregate of the pre-merger companies’ assets and registered capital. Generally, the post-merger entity would be a complete successor to the pre-merger entities, that is, it would assume all rights and liabilities of those entities. But creditors of the companies to be dissolved may opt to have their claims repaid in full before the completion of the merger.
Cross-border mergers are currently unavailable under PRC law, i.e., it is not possible to directly merge a foreign entity with a domestic company (including FIEs). For foreign investors, the only permissible forms of mergers in China are between FIEs and FIEs, or between FIEs and domestic companies. To effect these mergers, the FIE must be fully capitalized and must have started operations. The merger should comply with the Foreign Investment Catalog and the post-merger FIE should also comply with all other aspects of the PRC legal regime governing FIEs.

Debt Restructuring and Equity Contribution

Debt restructuring is formally recognized as one possible means of corporate restructuring. It is defined in a 2009 tax circular dealing with the tax treatment of corporate restructuring as “compromises made by the creditor on the debts” by agreement with a debt-ridden company or in “compliance with a court order.” Furthermore, since 2009, investors may use their equity in other Chinese companies as an in-kind capital contribution when setting up new companies.

However, due to restrictions imposed under regulations governing foreign investors’ acquisitions of non-FIE targets, these potential options can only be used for intra-group restructuring of a foreign investor’s investee companies in China.

Advantages and Disadvantages of Different Types of Acquisitions

The high-level summary below of the advantages and disadvantages of different types of acquisitions focuses mainly on share and asset acquisitions (the dominant types used by foreign investors).
<table>
<thead>
<tr>
<th>Type of Transaction</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
</table>
| Equity deals        | Direct acquisitions | • The only option available if the PRC target is a purely domestic company with no foreign parent company, i.e., not an FIE  
• Simpler and less administratively burdensome than asset acquisitions, because foreign investor does not need to “pick and choose” the preferred assets and businesses of the PRC target or execute individual assignment contracts for assets and businesses (which may require different formalities)  
• Various specific PRC legal requirements, such as state-owned asset valuation, may also apply and may further complicate the process.  
• (compared to asset deals:) The investor assumes, in proportion to its equity holding, all the PRC target’s obligations and liabilities, and restrictions applicable to it |

Guide to Mergers and Acquisitions
<table>
<thead>
<tr>
<th>Type of Transaction</th>
<th>Advantages</th>
<th>Disadvantages</th>
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<tbody>
<tr>
<td>Equity deals</td>
<td>- Not subject to PRC governmental approval, unless a PRC antitrust or national security review is required; disclosure to PRC tax authorities may be required</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Depending on the terms of the JV contract, may be able to avoid getting consent from other investors in the PRC target company or from the target’s board of directors</td>
<td>- Cannot be used for acquisitions of purely domestic targets with no foreign shareholders</td>
</tr>
<tr>
<td>Indirect/ off-shore</td>
<td></td>
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</tr>
<tr>
<td>Asset deals</td>
<td>- May cherry-pick preferred business and assets</td>
<td>- More complex than equity acquisition, as may involve different categories of assets and liabilities</td>
</tr>
<tr>
<td></td>
<td>- In general liabilities or restrictions will remain with the PRC target</td>
<td>- If carrying out the asset acquisition needs a new FIE, establishing it will require separate approval from the PRC authorities</td>
</tr>
<tr>
<td></td>
<td>- Generally not subject to PRC governmental approval, except for a few cases (depending on the type of assets; see Consents and Approval)</td>
<td>- Tax considerations for the parties in relation to the transfer of assets</td>
</tr>
</tbody>
</table>
Determination and Payment of Purchase Price

Depending on the type of transaction, the foreign investor may pay the purchase price in various forms, including currency and certain types of assets or property rights. Whatever the form of payment, for all transactions subject to PRC jurisdiction, PRC law sets out detailed time limits by which foreign investors need to fulfil minimum obligations.

Most types of transactions require that the purchase price must, in principle, comply with the results of a valuation by qualified appraisers. See the Asset Valuation section.

Assumption of Liabilities

The foreign buyer in a share acquisition generally assumes all the existing or contingent obligations and liabilities of, and restrictions applicable to, the PRC target company in proportion to its equity in the target. In an asset transaction, any existing obligations or liabilities of the target, or restrictions on it, generally remain the target’s sole responsibility.

But regulations and Supreme Court interpretations on assumption of liabilities when an enterprise is restructured have varying results depending on the specific type of transaction. This guide will not discuss these rules in detail. A final determination of debt assumption issues can be made only after careful consideration of these rules.

Possible Post-Acquisition Issues

As discussed above, in an indirect equity acquisition, neither the equity holding structure nor the assets of the target company are directly affected. A direct acquisition, on the other hand, directly affects the target’s equity holding structure: depending on the final shareholding structure, the target may need to be converted into an FIE.

While an asset transaction would not trigger any corporate conversion by itself, i.e., the selling company is still the same type of company after the transaction, the selling company may be may be liquidated and dissolved after the asset acquisition if it has sold all or almost all its business or assets to the acquiring FIE.
Finally, separate formalities may be required if the new foreign investor wishes to change corporate details of its own PRC entity or the target company (e.g. name, corporate officers) upon completion of the transactions. If any employees are transferred pursuant to the transaction, the relevant labor bureau registrations should also be amended (see Employment Issues). There may also be certain government title registration requirements associated with specific types of assets (see Asset Acquisitions).
Approvals for a New FIE

Establishing a new FIE generally requires contract approval by MOFCOM or its local counterparts (“COFTEC”), and (for larger projects) verification by the National Development and Reform Commission (“NDRC”) or its local counterparts (“local DRC”), depending on the proposed total investment of the new FIE, as follows:

<table>
<thead>
<tr>
<th>Encouraged or Permitted</th>
<th>If total investment of the project is:</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>• &lt; USD300 million – local DRC and/or COFTEC</td>
</tr>
<tr>
<td></td>
<td>• ≥ USD300 million but &lt; USD500 million – NDRC and/or MOFCOM</td>
</tr>
<tr>
<td></td>
<td>• ≥ USD500 million – NDRC and/or MOFCOM, to be submitted to State Council for verification</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Restricted</th>
<th>If total investment of the project is:</th>
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<tr>
<td></td>
<td>• &lt; USD50 million – local DRC and/or COFTEC</td>
</tr>
<tr>
<td></td>
<td>• ≥ USD50 million but &lt; USD100 million – NDRC and/or MOFCOM</td>
</tr>
<tr>
<td></td>
<td>• ≥ USD100 million – NDRC and/or MOFCOM, to be submitted to State Council for verification</td>
</tr>
</tbody>
</table>
For projects requiring MOFCOM approval and NDRC or State Council verification, the applicant submits its project application to the provincial-level DRC/COFTEC of the place where the project will be located. The provincial DRC then forwards the application to the NDRC/MOFCOM after preliminary verification.

Since July 2004, purely domestic projects not involving government investment require only verification (核准) or recordal (备案) (much like registration). But foreign-invested projects still need verification and approval.

**Project Verification System**

When reviewing an application for verification, the government will primarily consider: protection of national (including economic) security; rational development and utilization of resources; environmental protection; optimization of major overall arrangements; safeguarding of the public interest; and prevention of monopolies.

After obtaining the NDRC verification document, the applicant carries out procedures relating to land use, urban planning, quality supervision, work safety, use of resources, enterprise establishment (or amendment), foreign exchange administration, importing equipment and applicable tax policies.

**Approval of Establishment of an FIE**

In addition to NDRC verification, the Articles of Association and any joint venture contract or shareholders’ agreement of an FIE must be approved by the relevant approval authority according to these rules:

- An FIE in an encouraged business (with exceptions) or in a permitted business with a total investment of USD300 million or more, or a restricted business with a total investment of USD50 million or more, must be approved by MOFCOM.
- An FIE in an encouraged or permitted business with a total investment less than USD100 million or a restricted business with a total investment less than USD50 million, are approved by a provincial-level (or lower) counterpart of MOFCOM.
- Provincial-level counterparts approve FIEs with a total investment above USD300 million if the project does not require “comprehensive balancing of resources” (综合平衡) (i.e., state-allocated resources on a scale sufficient to figure in state plans).
- Provincial-level counterparts approve venture capital and venture capital management FIEs with registered capital of less than USD300 million.
An FIE is formally established when it has its approval from the approval authority and completes registration with and receives a Business Licence from the provincial or local counterparts of the State Administration for Industry and Commerce ("SAIC").

The general approval authority rules described vary in particular cases. The Central Government has promulgated a number of individual regulations, notices and policies with special rules for determining and delegating the approval authority for projects and transactions in certain sectors or industries. For example, sector-specific authorities, such as the China Banking Regulatory Commission ("CBRC") and the China Securities and Regulatory Commission ("CSRC") are the primary approval authority for their respective industries. Local authorities often publish individual rules to further refine delegation of approval power within their localities.

Accordingly the precise approval authority for any given project, company or transaction can only be determined after careful consultation of all of the relevant rules.

**Approvals for Acquisitions**

Besides establishing a new FIE as described above, a foreign investor may also buy established companies by either equity acquisition or asset acquisition (as explained in Types of Transaction). This section summarizes relevant formalities for these acquisitions.

**Indirect Acquisitions**

As an indirect acquisition is conducted offshore by acquiring equity in an offshore entity, PRC authorities generally have no jurisdiction over the transaction and the transaction will, by and large, require no PRC approval, except for the antitrust review and national security review procedures summarized below.

**Antitrust Review**

Pursuant to the 2008 Anti-Monopoly Law (the "AML"), the State Council, MOFCOM, the NDRC and the SAIC have promulgated various regulations clarifying how the AML will be applied and how various practices will be scrutinized.

- Any transaction resulting in a party acquiring control or decisive influence (a "concentration") must be reported for clearance to MOFCOM’s Anti-Monopoly Bureau if the following thresholds are met:
• all participating business operators’ combined worldwide revenue in the previous accounting year is over RMB10 billion, and at least two business operators have PRC revenue over RMB400 million each; or

• all participating business operators’ combined PRC revenue in the previous accounting year is over RMB2 billion, and at least two business operators have PRC revenue over RMB400 million each.

• MOFCOM has discretion to investigate any transaction that fails to meet the thresholds, but has not yet exercised this discretion.

• Anti-competitive practices are prohibited and may result in fines and damages. These practices include:
  
  • Horizontal agreements between competitors, such as price fixing (especially through trade associations, and either as agreements or as “concerted practices” such as parallel price increases), bid-rigging, output restrictions and market allocation;
  
  • Vertical agreements for resale price maintenance as well as non-price related restraints of trade (imposing exclusivity, restricting the use of new technology or curtailing R&D);
  
  • Abuse of dominance such as predatory pricing, loyalty rebates, or refusing access to an essential facility; and
  
  • Abuse of administrative monopoly such as illegitimate barriers to inter-provincial trade and investment.

• Some of the above practices may be still be acceptable if the parties can show that they meet certain conditions such as improving technology, improving product quality, creating efficiencies or protecting the environment, as long as the consumer gets a fair share of the resulting benefits.

• A leniency program lets companies turning themselves in for anti-competitive conduct enjoy partial or total immunity from fines.

National Security Regime

The State Council and MOFCOM issued regulations in 2011 fleshing out a national security review procedure already referred to in general terms in the 2006 Regulations on Foreign Investors’ Acquisition of Domestic Enterprises and the 2008 PRC Anti-Monopoly Law.

A joint committee led by the NDRC and MOFCOM is responsible for carrying out
a review to determine whether a transaction will have a major impact on national security. If that impact cannot be mitigated, the transaction will not be permitted to go forward. To make that determination, the review considers impact on:

- national defense;
- national economic stability;
- social order; and
- R&D capabilities for key technologies affecting national security.

The onus is on the investor to file for a national security review before seeking approval if the transaction could raise national security concerns. The approval authority may also on its own discretion decide that a national security filing with MOFCOM is required, and suspend approval pending the results of that filing.

A filing is required if the acquisition would give a foreign investor actual control of a domestic defense enterprise, or a non-defense enterprise which (1) has a bearing on national security and (2) involves industries such as major agricultural products, major energy sources and resources, major infrastructure facilities, major transportation services, key technologies and the manufacture of major equipment.

Direct Acquisitions

Under current PRC law, transactions involving transfer of the registered capital of an existing FIE or conversion of a domestic LLC (or SOE) into an FIE via a direct equity transfer would require approval and registration, similar to the situation where a new FIE is formed. MOFCOM and/or its local counterparts have the power to examine and approve transactions involving such foreign investments in domestic companies and FIEs (unless regulations otherwise specify, often where the target companies are in certain special industries). The SAIC and its local branches (AICs) carry out registration procedures once the proposed transaction has been approved.

Approval Authority

The rule in relation to the approval authority of a direct equity acquisition is similar to that for the establishment of a new FIE.

An application should be filed with the target FIE’s original approval authority. If the target is currently not an FIE, then the application should be filed with MOFCOM or the provincial COFTEC, depending on the size of the total investment and the industry involved.
Under the Regulations on the Acquisition of Domestic Enterprises by Foreign Investors ("M&A Regulations"), the parties to an acquisition must report to MOFCOM if the target company is in a "key industry", there are factors that affect or might affect "national economic security" (discussed above), or if there is a change of control over a "famous trademark" or "renowned Chinese brand".

MOFCOM approval is also required when offshore companies controlled or established by Chinese enterprises or natural persons acquire Chinese affiliates. The M&A Regulations require parties to the acquisition to declare any affiliation between the target, the buyer and the seller.

**Asset Valuation**

In general, if the target is not an existing FIE, the parties must have the value of the equity appraised before the transfer. Prices manifestly lower than the appraisal result are forbidden.

If the acquisition involves a transfer of state-owned equity, whether the target is an existing FIE or not, the seller must appoint an asset appraisal institution with appropriate qualifications to carry out an asset appraisal. The appraisal results must be approved or registered by the state asset administration authorities, and the transaction price must be based on those appraisal results. In general, the transaction price and the appraisal may not differ by more than 10%.

**Documentation Requirements**

Parties to a direct equity transfer transaction must enter into an agreement to transfer or subscribe for the target’s registered capital. This equity transfer or subscription agreement must be governed by PRC law and will be reviewed by the approval authority.

The target’s Articles of Association (and the JV contract or shareholders’ agreement, for a JV or a WFOE with multiple investors) will have to be amended to reflect the changes. Where the transaction converts the target into a JV or a WFOE with multiple investors, a new joint venture contract or shareholders’ agreement is needed. The amendments or new corporate documents are also reviewed by the approval authority along with the equity transfer agreement.

Other documentation required generally includes a unanimous board resolution of the target, consent from existing co-investors in the target and waiver of their pre-emptive rights to buy the equity transferred, or a unanimous shareholders’ resolution in case of acquisition of domestic LLCs (see Non-Governmental Consents and Approvals). The approval authority may also require the parties
to submit other documents for its review, such as bank letters evidencing the buyer’s financial soundness, board resolutions of the parties approving the equity sale, constitutional documents of the parties or other contracts or documents referred to in the transaction documents.

Under applicable rules and prevailing practice, all documents submitted for review and approval need to be in Chinese (with translations of essential documents from other jurisdictions). Officials can refuse to review documents not available in Chinese, delaying the approval process. The M&A Regulations require copies of the foreign investor’s constituent documents to be legalized or authenticated, and this may also be required for other documents in practice (for example, appointments of directors). Local practice and individual reviewing officials often require that certified translations be provided, though this is not legally required.

Approval Process and Timing

Upon receipt of all necessary documents, the approval authority will review the substance of their Chinese versions, and may ask for changes to terms it considers inappropriate. The parties may need to negotiate with the approval authority if they object to those changes.

A number of factors (such as transaction size, locality, approval level, industry, complexity and sensitivity) can significantly affect the time required for approval of a given transaction, which can range from just a few days or weeks to more than a year.

Special Procedures for State-Owned Equity

Unlisted Equity

If a foreign investor is buying state-owned equity (other than in financial enterprises or listed companies) and the target is to be reorganized as an FIE, special procedures must be followed.

The seller will have to submit a reorganization plan to the relevant government authorities for approval. The seller must also appoint a qualified institution to carry out an asset appraisal.

Subsequently, approval procedures for the FIE are then carried out on the strength of the approval documents for the reorganization plan and the acquisition agreement.
Administration Commission ("SASAC") and the Ministry of Finance provide that transfers of state-owned equity (other than in financial enterprises or listed companies) must be carried out at one of China’s property rights exchanges, unless laws and regulations provide otherwise. The goal is to increase transparency and stem losses of state asset from sales by corrupt officials at much less than actual value.

Under the rules, sellers must make a public announcement through a property rights exchange on the equity they propose to sell. If more than one prospective buyer emerges during the prescribed notice period, the equity must be sold by means of an auction or tendering process. The main problem with this system is, of course, that foreign investors who have put a lot of time and resources into negotiating an acquisition may find themselves competing with other bidders in an auction or tendering situation near the end of the process.

**Listed Shares**

Provisional measures issued jointly by SASAC and CSRC in 2007 ("Order 19") regulate the transfer of listed shares of a state-owned shareholder (except those held by state-owned financial institutions), whether through the securities exchange, by agreement, allocation (without consideration) or through direct transfer. Where the transfer is by agreement, Order 19 requires the state-owned shareholder to publicly solicit potential transferees through a public announcement on the securities exchange after the initial approval by SASAC or its local counterpart. Exceptions are available only in limited circumstances, such as where there are special requirements for the transferee in key industries or areas of national economy.

According to Order 19, depending on the listed company’s total capital, the percentage of shares being sold and whether there is a change of control, the share transfer plan will be subject to recordal or approval of SASAC or its provincial counterpart.

**Registration Process**

Following approval of the transaction, the target company must file with the local AIC an amendment of any existing registration particulars affected by the transaction, such as the company name, business scope, investor, amount of total investment/registered capital, and principal officers and directors.
Asset Acquisitions

A foreign investor which wishes to acquire assets, rather than equity, must have a registered presence in the PRC. This could be an existing FIE in China or an FIE newly established for the purpose of acquiring and operating the purchased assets. Any new entity must be approved.

Possible Governmental Approvals

Apart from approval for establishment of a new FIE, transfers of certain assets (such as those listed below) require additional approvals.

- When all of the assets, or the main assets, of a state-owned enterprise or a company with state-owned equity are sold to a foreign investor for the establishment of an FIE, the assets must be appraised and the appraisal results approved or registered. The approved or registered appraisal results form the basis for the transaction price. Also, a reorganization plan and the acquisition agreement must be approved. In some circumstances, the acquisition agreement may be approved by the parent company rather than government authorities.

- Other transfers of state-owned assets must also be appraised in accordance with the state-owned asset appraisal regulations.

- If the transferred assets involve certain tax-exempt equipment still under customs supervision and control, the customs authorities must approve release of the supervision (normally involving retroactive payment of taxes and duties exempted or reduced).

- If the transferred assets involve certain types of intellectual property rights (such as patents and trademarks) or technology or know-how subject to the PRC technology export administrative regime, separate approvals/formalities may be required.

Particular care must be taken if the asset transfer involves certain special industries in which foreign participation is restricted. While the asset transfer as such may not need approval, the licenses needed to operate in these sectors cannot be transferred, so the buying FIE must apply for its own license before it can make use of the assets.

In certain asset acquisitions, foreign exchange approval and examination may be required (see Direct Acquisitions).
Documentation Requirements

If the foreign investor does not have a registered presence in China and needs to form a new entity as the acquisition vehicle, it would need the same type of documents and approvals to establish a new entity as discussed earlier.

The parties to an asset transfer should enter into an appropriate asset transfer agreement for the primary transaction.

Depending on the nature of the transaction and the approval requirements, other documentation required could include a resolution of the seller of the assets approving the sale, notification to creditors and staffing plans (see Non-Governmental Consents and Approvals). As for an equity acquisition, any documents submitted should be in Chinese and may need to be notarized or legalized.

Follow-Up Formalities

If any of either party’s corporate constitutional documents or principal company particulars will change as a result of the transaction, the changes may need approval from the respective approval authorities and registration with the SAIC. Title registrations for certain types of assets such as real estate or vehicles may also need to be updated.

Mergers

Mergers of two or more FIEs should generally be approved by the original approval authority of those FIE[s] and/or the approval authority for FIEs to be established as a result of the merger. Where the merger involves more than one approval authority, it should be approved by the approval authority with jurisdiction over the post-merger FIE. After approval of the merger, registration procedures should be carried out with the SAIC or its local counterparts.

Non-Governmental Consents and Approvals

Besides the consents and approvals from approval authorities mentioned above, certain other non-governmental consents and approvals may be required to complete the transaction, because they are statutory requirements (and so would be part of the application) or they are required by contract.
Consent of the Seller

Consent of the seller is generally evidenced by a shareholders’ resolution. This is normally a non-governmental approval but in the case of state-owned equity, it often involves approval of a government authority performing the role of shareholder on behalf of the state.

If the equity being transferred is state-owned equity held by a state-owned asset authority, the state-owned asset authority must approve the transfer. If the transfer would cause the state to lose its controlling interest, the People’s Government at the same level as the state-owned asset authority must also approve the transfer.

If the equity being transferred is state-owned equity in a subsidiary of an enterprise, which in turn is held or partly held by a state-owned asset authority, the enterprise must approve the transfer. If the subsidiary is a major subsidiary and the transfer is a major transfer, both the state-owned asset authority and finance authority at the same level must approve.

Consents and Waivers from Other Shareholders

Under PRC law, in a direct equity transfer transaction, consents to the transaction will be required from all co-investors of a JV. These co-investors have pre-emptive rights to buy any equity offered for sale by the selling investor. These rights must be waived before the equity can be sold to a third party.

Where the target in a direct equity transfer transaction is a domestic limited liability company, the M&A Regulations require unanimous consent of the target’s shareholders.

Board Approval

Before an equity or asset acquisition, a directors’ resolution of all entities involved (transferor, buyer and target) in favor of the transaction is normally required. In an equity transaction, the resolution from the PRC target company in favor of the transaction and the necessary amendments in the company’s corporate documents will usually be unanimous (which facilitates approval). However, since directors in a PRC FIE or LLC are normally appointed and controlled proportionally by the investors, once the co-investors’ consents and waivers are obtained, this requirement is usually just a formality.
Approval from Employees

The M&A Regulations require submission of a labor settlement plan to the Approval Authority for both asset acquisitions and direct equity acquisitions. The settlement plan should cover issues such as how many employees might be dismissed as a result of the acquisition and how unpaid salaries, benefits and severance pay will be paid. If a transfer of state-owned equity implicates workers’ rights and interests, the employee representative council must approve matters such as the resettlement of workers. In an asset acquisition, a transferred employee is entitled to severance pay as a result of the termination of his or her employment with the seller. In practice, most employees are willing to waive their right to severance if the buyer agrees to count the transferred employee’s previous years of service with the seller when calculating severance pay for any subsequent termination.

A company considering restructuring or other major operational matters should listen to the trade union’s opinion, and to employees’ opinions and suggestions (through an employee representative council or otherwise). But in practice this is not often done.

Contractual Obligations

Other contractual obligations of the transferor, buyer or target may require third-party approval for either an equity or asset sale. For example bank loans or security agreements may require the lender’s prior approval for a change of control of the borrower.

Public Announcements and Creditor Notifications

A domestic company selling its assets to a buyer should notify its creditors and make a public announcement in a newspaper at the provincial level or above with national circulation, at least 15 days before applying to the approval authority to approve the asset sale.

The seller of assets generally remains responsible for its debts and liabilities. But the seller may make an agreement with the buyer and other creditors on the disposal of debts, as long as the agreement will not harm third-party rights. That agreement should be submitted to the approval authority as part of the application documents.
Overseas Investment by PRC Enterprises

A PRC enterprise’s investment in an overseas company requires registrations with the State Administration of Foreign Exchange (“SAFE”) and approvals from the NDRC and/or MOFCOM, which may be time-consuming. The feasibility of these registrations and approvals may also affect the acquisition structure. If a direct or indirect acquisition by a foreign investor involves any overseas investment by the PRC seller or target, these approval requirements need to be taken into consideration.
Background

China imposes strict control over all types of foreign exchange transactions across its borders, and its currency is not freely convertible in international foreign exchange markets. SAFE, the PRC authority in charge of foreign exchange, regulates these four types of transactions involving movement or conversion of foreign exchange:

- Inward remittance of foreign exchange, i.e., the remittance of foreign exchange into China from an overseas party
- Settlement of foreign exchange, i.e., the conversion of foreign exchange into RMB
- Purchase of foreign exchange, i.e., the conversion of RMB into foreign exchange
- Outward remittance of foreign exchange to an overseas party

Current Account and Capital Account Items

China’s foreign exchange regime distinguishes between “current account items” (generally, funds for the daily operations of a company, such as revenue from export or provision of services, payment for imported goods) and “capital account items” (generally, items of a non-trade, nonrecurring nature, such as investment in China, real estate purchases, repayment of principal of foreign currency loans and contributions to registered capital).
Current Account Items

China’s foreign exchange control regime permits the so-called “current account convertibility of the RMB.” In essence, PRC companies’ current account foreign exchange transactions do not require SAFE’s prior approval. Instead, PRC companies need only submit documentation of the transactions to the PRC-designated foreign exchange bank for verification when converting currency.

Capital Account Items

Foreign exchange transactions involving capital account items, on the other hand, are currently more heavily regulated (although the PRC government has announced its intention to gradually move towards full capital account-convertibility of the RMB). Accordingly, cross-border capital account foreign exchange transactions, such as receipt of the purchase price under a direct equity acquisition or a foreign investor’s capital injection into an FIE, require prior approval from SAFE or its local counterpart.

Approval for Foreign Exchange Transactions

There are detailed rules specifying the approval authority which local banks and local branches of SAFE exercise over each type of foreign exchange transaction. These rules change periodically but the general trend is for SAFE to delegate more authority to approve foreign exchange transactions to local banks.

Remittance Issues

While PRC statutes allow multiple forms of payment for a merger and acquisition transaction, some foreign buyers may opt to pay the purchase price for the relevant interest or assets transferred, utilizing foreign currency funds currently held outside of China. This means that, in M&A involving foreign investors acquiring targets in China, generally, the “inward remittance” and “settlement” aspects of foreign exchange control are more relevant.

Payment to a Foreign Seller Outside of the PRC

Where the seller in either an indirect acquisition or a direct acquisition is a foreign company with a bank account outside of China, the foreign buyer typically pays the purchase price completely offshore to the foreign seller. Since such payments do not cross the PRC border, SAFE would not have jurisdiction over them.
On 21 October 2005, SAFE issued the Notice on Foreign Exchange Control Issues Relating to Financing and Round Trip Investment by Domestic Residents through Offshore Special Purpose Vehicles (“SAFE Notice 75”) which sought to clarify procedures for offshore investments by PRC residents. A new SAFE Notice 19 issued on 20 May 2011, provides current details of the registration requirements for offshore fundraising and round trip investment activities.

Requirements Under SAFE Notice 75

SAFE Notice 75 applies to PRC residents, including both legal entities and natural persons. PRC residents who wish to establish or gain control of an offshore special purpose vehicle (“SPV”) for the purpose of offshore financing or round trip investment (including initial public offerings, offshore private placement, bridge loans, or capital contributions such as stock-swap transactions) must register with the local SAFE. PRC residents with existing offshore structures were required to retroactively register with SAFE by 31 March 2006, but retroactive registration can still be done (subject to penalties).

After the PRC resident injects domestic assets or equity into an SPV, or the SPV carries out financing following such injection, the PRC resident should amend its registration accordingly with the local SAFE. After the SPV completes its offshore financing, the funds raised may be repatriated into China in accordance with the business plan submitted to the local SAFE for registration of the SPV, or the prospectus. Any foreign exchange proceeds received by a PRC resident from the SPV must be repatriated within 180 days of receipt.

If the SPV undergoes a material change in capital other than a round trip investment (e.g., capital increase or reduction, equity transfer, swap, merger or division, long-term equity or debt investment or provision of security to a third party), the PRC resident must report the change to the local SAFE within 30 days.

Payment to a Seller in the PRC

Equity Acquisitions

If the transaction involves a seller who must be paid in China, the foreign investor will have to remit the purchase price into the PRC. The purchase price will typically be remitted in foreign exchange to a special account that the seller establishes, upon SAFE approval, for the specific purpose of receiving these funds. The PRC seller must then submit supporting documents to the bank to convert the foreign exchange in the special account into RMB, and remit the RMB out of the special account. The foreign investor must carry out (or authorize the seller to carry out) special foreign exchange registration for the foreign exchange.
it pays to the seller. A registration certificate is then issued, which evidences the foreign investor’s payment and is used by the target company for its foreign exchange registration procedures. It is at this point that any overseas investments by PRC residents into SPVs must be disclosed, as discussed above.

Under the M&A Regulations, a foreign buyer may also pay the purchase price with (1) lawfully obtained RMB profits (upon local SAFE approval), or (2) listed shares or pre-IPO shares of an offshore company (upon MOFCOM approval), if the shares fulfil certain conditions and comply with required approval procedures.

**Asset Acquisitions**

In an asset purchase involving the formation of a new FIE as the acquisition vehicle, the new FIE will first need to be funded. A capital account will be established to receive the capital contribution funds.

The PRC foreign exchange regime requires all transactions in China to be priced and settled in RMB, so the buying FIE must use RMB to purchase assets from a domestic company. Those RMB may come from conversion of part of its initial capital contributions or from its operational income.

In any event, the payment to the seller, being in RMB, will typically not trigger specific foreign exchange issues.
Most of the information discussed below applies primarily to sellers, but it may also affect buyers, due to potential withholding requirements and to sellers seeking to pass on the tax burden through the price of the acquisition.

**Jurisdictional Taxes - Enterprise Income Tax**

**Registered Capital Transfer**

If a foreign investor sells its interest in the registered capital of an FIE at a gain (meaning that the selling price exceeds the original value of the capital contribution now sold), that gain is subject to Enterprise Income Tax ("EIT") at the rate of 10%, unless reduced or exempted by an applicable tax treaty. If the buyer is a PRC entity or individual, the buyer must withhold tax on the capital gain earned by the foreign seller. But according to a 2009 tax notice, if both the seller and the buyer are foreign investors and the transaction takes place outside of China, the buyer does not have a withholding obligation. Instead, the seller is responsible for the tax filings and payment. The target FIE whose equity has been transferred must also file the equity transfer contract with the tax authorities and assist them in collecting the taxes.

**Assets Transfer**

Gains or losses on an FIE’s disposal of assets must be included in or deducted from the FIE’s taxable income for enterprise income tax purposes.
Transactional Taxes

Stamp Tax

Generally this tax is levied on each copy of the document to be stamped. Stamp tax rates vary depending on the type of transaction. For equity acquisitions, the stamp taxes would generally be 0.05% of the transfer price. For asset acquisitions, asset transfers attract stamp tax only when the stamp tax regulations explicitly list the transferred assets (e.g., inventory, real estate, automobile, copyright, trademark, patent, know-how). Transfers of other assets (e.g., accounts receivable, contractual rights) do not attract stamp tax. To minimize stamp tax liability, the value of each transferred asset should be separately listed in the assets transfer agreement. If there is no separate value listed for the assets transferred, the total transfer price is subject to stamp tax.

Value Added Tax ("VAT")

Transfers of assets in the PRC are subject to VAT while equity transfers are not. VAT will be levied on the transfer price of the inventory at the rate of 17%. Used fixed assets on or after 1 January 2009 are also subject to VAT at a rate of 17%. However, used fixed assets bought before 1 January 2009 are subject to VAT at a rate of 4%, half of which is exempted, but no input credit is available.

Customs Duties

Certain FIEs may, in some circumstances, import machinery and equipment free of custom duties. But such machinery and equipment is bonded, i.e., subject to the supervision and control of the customs authorities, for a period of five years. During this period, if the bonded equipment is sold, consent from the customs authorities would be required, and custom duties would be levied retroactively based on the depreciated value of the bonded equipment.

Land Appreciation Tax

Land appreciation tax is levied when land use rights or buildings are sold at a gain. The tax rates range from 30% to 60% of the gain, although certain items may be deducted. For many years this tax was not consistently collected, but recently local governments have collected it more consistently as a result of central government efforts to combat property speculation and stabilize property prices.
Business Tax

Business tax at the rate of 5% may be levied on the transfer price of intangible assets such as copyrights, trademarks, patents, know-how and goodwill, but transfers of technology may be exempt. Business tax also applies to the transfer of land use rights and building ownership rights.

Business tax is now progressively being replaced by VAT in many localities.

Deed Tax

Deed tax may be imposed on the buyer of land use rights or building ownership rights. The tax rate varies from 3% to 5% of the transfer price, depending on the location.

Specific Tax Considerations

Equity Acquisition

**Indirect acquisition** An indirect acquisition can take place wholly offshore. Until 2008, such acquisitions did not trigger PRC tax liabilities. But Notice 698, issued in December 2009 with retroactive effect from 1 January 2008, has significantly changed the situation.

Briefly, capital gains derived from the transfer of equity of PRC resident enterprises by foreign entities are subject to a 10% tax (which in a few cases may be reduced by an applicable tax treaty). Notice 698 requires foreign entities to disclose to the PRC tax authorities indirect transfers of PRC resident enterprises when the offshore holding company making the transfer is in a low tax jurisdiction or a jurisdiction which exempts income tax on foreign-sourced income. The PRC tax authorities then determine whether the offshore holding company is a shell company, and if so, may deem the indirect transfer a direct transfer of the Chinese resident enterprise, making the capital gain associated with the offshore transaction subject to PRC tax.

**Direct acquisition** If the seller is an enterprise in China, its capital gains from the sale of shares to a foreign buyer are treated as part of that enterprise’s taxable income for purposes of the Enterprise Income Tax (“EIT”) Law. EIT is generally levied at the rate of 25% on an enterprise’s net income. If the seller is a foreign company, its capital gains will be subject to withholding tax at the rate of 10% unless exempted or reduced by an applicable tax treaty.
Sale of equity is subject to turnover taxes except stamp tax. Generally, both buyer and seller must pay stamp tax of 0.05% on the share transfer price. If the company is a joint stock limited company listed on a PRC stock exchange, the seller alone pays 0.1% stamp tax on the transfer of the listed shares.

**Asset Acquisition**

As mentioned above, assets transfers attract a variety of PRC taxes.

Many FIEs established before 16 March 2007 enjoyed tax holidays if they remained in operation for at least 10 years. But if an FIE sells its assets and liquidates before that 10 years was up, it had to pay the taxes originally exempted or reduced by the tax holiday. The EIT Law no longer has these tax holidays, but the potential clawback remains an issue for FIEs formed before 16 March 2007, until they have operated for 10 years.

**Merger**

The merger of two FIEs in China generally will not qualify for tax-free treatment.

For a taxable merger, gain or loss needs to be recognized as under a liquidation or an asset transfer, and accumulated losses and other tax attributes cannot be used by the post-merger entities.

Although a merger of two FIEs generally will not enjoy tax-free treatment for EIT purposes, most of the turnover taxes, such as VAT and business tax, that apply to asset transfers can be avoided in a merger. Therefore, a merger could still be more tax efficient than an asset transfer, depending on the type of assets to be transferred.
Rules on employee transfers and their ramifications vary depending on whether the transaction is a merger or an acquisition, and also on what the target entity is.

FIEs and domestically owned (non-FIE) companies may directly hire Chinese and expatriate staff. In contrast, Rep Offices cannot directly hire PRC citizens. Instead, Rep Offices must contract with FESCO (“Foreign Enterprise Service Company,” or sometimes another local labor service company) to have FESCO employees seconded to the Rep Office. But Rep Offices and their employees may, and commonly do, enter into direct agreements to supplement the terms of the standard FESCO labor service contracts.

The terms of all employment relationships in China must be set out in written contracts. PRC law does not permit transfer or assignment of rights and obligations under an employment contract directly from one employer to another. Under the PRC Labour Law, Labour Contract Law and relevant regulations, an employment relationship can be terminated only in specified circumstances, which are quite narrow.

Transfer of Employees

Equity Acquisitions

As a PRC legal matter, equity acquisitions do not trigger transfers of employees, as there are no changes to the target company’s (the employer’s) structure. But

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1 Expatriates are generally hired by the overseas head office, then registered as representatives of the Rep Office.
in practice, many acquisitions are followed by further corporate restructurings, which may lead to employee transfers or terminations, as discussed below.

An employer trying to terminate employment contracts in a restructuring should, if circumstances permit, cite a legitimate statutory ground for termination, such as “a major change in the objective circumstances on which the employment contract was based” or one of the statutory grounds for collective dismissals. However, courts generally will not view a simple equity transfer as a change in objective circumstances sufficient to justify terminating the employment contract. Employers must generally do some other restructuring, such as shut down a business division or introduce a new production method or major new technology, before termination can be carried out on these grounds. Local rules and practice should be consulted as to the likelihood of a successful termination. Employment contract terminations may trigger a statutory and/or contractual requirement to make severance payments.

A special rule for foreign investors gaining a controlling interest in an SOE is discussed below.

Asset Acquisitions

Based on the current legal framework, a transfer of assets will not carry with it the obligation to transfer any employees (but see the discussion below of special rules applicable to SOE acquisitions).

If the parties to an asset acquisition do wish to transfer relevant employees to the buyer, then the current employment relationship must first be terminated (either by employee resignation or mutual agreement), then the employee must sign a new employment contract with the buyer. In other words, there is no automatic or direct transfer of employees between two separate entities, and employees may only be “transferred” through termination and rehire.

SOE Acquisitions

Special rules apply to SOE equity and asset acquisitions. When a foreign investor acquires a controlling interest in an SOE and the SOE is reorganized as an FIE, or the foreign investor acquires an SOE’s main business assets and uses them to establish an FIE, an employee resettlement plan must be prepared and approved by the SOE’s employee representative council. The plan must also be submitted to the approval authorities, and included in the transfer agreement.

The SOE must use its existing assets to pay outstanding wages, non-refunded pooled contributions and unpaid social insurance premiums.
The SOE must also pay severance payments to employees who are not retained, and must make lump-sum payments of the required social insurance premiums for employees who are transferred to the local social insurance authority to take care of. The funds for these payments are to be deducted from the net assets of the SOE or on a priority basis from the proceeds derived from the sale.

Mergers

FIEs - In a merger, unless agreements between the pre-merger entities and their employees provide otherwise, all employees’ employment contracts will automatically be transferred to the post-merger entity. So long as the employees continue to work for the post-merger entity, the merger does not trigger a severance payment liability.

In general, employee consent would be required to amend or renew employment contracts pursuant to a merger. But under certain circumstances, the post-merger entity may be able to unilaterally terminate certain redundant employees following a merger. In that case, the post-merger entity will have to make severance payments.

Rep Offices - Rep Offices are not legal persons and so cannot merge with one another. If a foreign company with one or more Rep Offices in China is merged offshore with another entity, the Rep Offices would have to amend the relevant FESCO service contracts and supplementary agreements, primarily because the name of their parent company will have changed (though in some cities, the authorities may order the Rep Office to shut down as a result of the offshore merger if they cannot be convinced that the original overseas head office of the Rep Office still exists). Otherwise, there are no employee termination or severance requirements unless the Rep Office is ordered to shut down, in which case a new Rep Office would need to be established and would need to sign a new labor service contract.

Other Considerations

Payments of Taxes, Social Insurance Contributions

A buyer should make sure that individual income taxes, social insurance contributions and, as applicable, severance payments for employees are paid by the seller or as agreed by the parties.
Expatriates

If the employees to be transferred are expatriates (including Hong Kong, Macau and Taiwan residents), who are required to maintain valid employment visas and employment/residency permits, there might have to be documentary amendments. Expatriates may also have “golden parachute” arrangements that a potential buyer should be aware of.

Transfer of Benefits, Location

For Chinese and expatriate employees alike, the buyer should consider current employee benefits. If the transfer requires movement to a new location, the buyer must itself (or through service providers in the new location) arrange for the employees to have proper work and residency documents as well as benefit accounts at the new location.

Non-Competition and Confidentiality Obligations

The buyer should also consider whether existing employment contracts contain non-competition and confidentiality obligations that create liability for employees or even the buyer. Under the Labour Contract Law, the maximum term of a non-competition restriction is two years after the end of the employment relationship, and compensation must be paid in monthly instalments after the end of the employment relationship. Local regulations may specify a minimum amount that the employee must be paid. Since the buyer is in effect the new employer, ideally a waiver should be sought for this issue.

Dispute Resolution - Labor Arbitrations

Under applicable regulations, disputes between an employer and an employee arising from an employment relationship (or its formation or termination) are subject to labor arbitration procedures. Accordingly, should any disputes arise due to employee arrangements following the merger or acquisition, the parties would generally have to go to labor arbitration, whose quality can vary. Labor arbitration decisions can generally be appealed to a People’s Court if either party is dissatisfied with the decision, although the employer’s right to appeal is greatly restricted in certain types of disputes.
Preliminary/Framework Agreement

There is no PRC legal requirement for a preliminary or framework agreement between the parties, such as a letter of intent ("LOI") or memorandum of understanding ("MOU"), for merger and acquisition transactions. Nevertheless, an LOI or an MOU is an important tool that can be used to reach agreement at an early stage on the principles, basic terms and contemplated procedures of a proposed transaction, and it usually is prepared in major transactions. Note that although LOIs and MOUs are generally stated to be non-binding, the Chinese parties usually expect that all the terms in the LOI/MOU will be replicated in the formal agreements should the transaction proceed.

Due Diligence

Due diligence investigations remain an essential tool for assessing and reducing the risks inherent in a merger/acquisition transaction in China. In the absence of complete knowledge of the operations, the scope of the assets and the extent of the liabilities of the target company, due diligence investigations give the prospective buyer an opportunity to assess the legal and financial state of affairs of the target. They also facilitate consideration of structuring issues. Accordingly, due diligence is vital in most M&As in China.

However, the concept of due diligence is relatively new to many PRC target companies. Many PRC companies do not keep proper corporate or accounting books and records, and Chinese parties are used to concluding transactions
without any pre-acquisition documentary review of target companies. As a result, foreign buyers may still find some Chinese parties quite reluctant to fully disclose information about the target. There have also been cases of lawyers, accountants and other business professionals being accused of violating China’s vague state secrets regime because they were closely inspecting certain financial and management records of Chinese SOEs. Document forgery can also be an issue when dealing with some Chinese parties. Generally, foreign investors and their advisers need a high level of patience, experience and diplomacy to carry out proper due diligence investigations up to international standards.

Due Diligence Process

Typically, the due diligence process begins with the buyer and its advisers determining the nature and scope of the due diligence investigations. A written questionnaire or checklist identifying essential matters to be investigated may be prepared and sent to the target company which the seller, target company or its advisers then formally answer, providing copies of the requested documents. The buyer and its advisers may also carry out site visits at the target company and interview its management and staff to obtain more comprehensive information on various matters. While the buyer and its advisers typically need to drive the due diligence process in the PRC, more sophisticated sellers increasingly are hiring advisers and prepare organized data rooms.

Main Areas Covered in Due Diligence

Generally, the following areas will be examined in a comprehensive due diligence investigation.

Constitutional Documents, Government Approvals and Licenses

The target company’s constitutional documents must be carefully examined to ascertain that the target was duly established and is carrying out its business operations in accordance with its constitutional documents, operational approvals, permits and licenses, and PRC laws. Depending on the target’s form of establishment, its constitutional documents may include the Articles of Association, joint venture contract or shareholders’ agreements (if applicable), business license and establishment approvals.

If the target is in an industry that requires special licenses or permits to conduct its business, the buyer should check whether the target has obtained all the required licenses and permits.
Company Structure

The buyer should examine the corporate structure and the relationship between the target company and related companies, including historical changes to the corporate structure and shareholdings, to ensure that previous transfers were legally effected and that current equity holders have valid ownership of their equity. For SOEs that have undergone past restructuring, it is not uncommon for the restructuring to have been completed without proper and complete legal documentation and approvals, and buyers often need to enter into further discussions with the buyer and government authorities (particularly the state asset administration) to get a clearer picture of past restructurings and disposition of assets in such restructurings.

Assets

The buyer should ascertain whether the target company has title to all of its assets and to what extent the assets are subject to charges, mortgages, liens or other third-party rights and interests.

Accounting

Accounting practices in China are not necessarily identical to international accounting practices. The buyer should retain its own accountants to conduct financial due diligence on the target company.

Loans and Guarantees, Creditors and Debtors

The buyer needs to be aware of target company loans (either as lender or borrower) and guarantees provided by the target, as they may affect its valuation. For SOEs, buyers should look for cross-guarantee arrangements with other SOEs, which are not uncommon.

Taxation

The buyer should request documents demonstrating that the target company has paid taxes (such as EIT or business tax) and withheld its employees’ individual income tax. The buyer should also determine whether the target company has committed any tax or customs duties violations or has any outstanding tax disputes or liabilities, and whether it is entitled to any preferential tax treatment (e.g. income tax holidays, reduction of income tax rate, exemption from customs duties, fiscal subsidies or tax rebates) from the PRC government.
Land and Buildings

Ownership of real property is one of the most complex and potentially problematic areas in China M&A transactions. The buyer’s legal advisers should carefully review purchase and title documents of land and buildings, such as land use rights grant contracts, land use rights ownership certificates, building and factory ownership certificates, land transfer contracts and lease agreements. It is important to ascertain whether the target company has carried out all its obligations under the land-related contracts, such as for payment and development. The buyer should also retain local agents to conduct searches in the public registry and investigate whether there are outstanding mortgages, third-party rights, claims or encumbrances registered against any real properties, as not all encumbrances show up on title documents. Independent appraisals also may need to be carried out to ascertain the value of the primary properties.

Material Contracts

Material contracts should be examined to determine their potential impact on the target company’s valuation and if there have been or may have been breaches. Such contracts include major supply agreements, contracts with key customers and purchase contracts for expensive or vital equipment.

Labor and Social Insurance-Related Matters

The buyer should ascertain whether the target company’s labor practices are in line with PRC statutory requirements. For example, many PRC manufacturers require their employees to work overtime but do not properly pay them for it, and some use child labor. Another issue is whether statutory labor benefits and social insurance contributions have been properly handled, as the target company may be liable to make up past due pension and social insurance contributions. Labor contracts between the target company and its key employees should be reviewed to ascertain what additional arrangements or benefits have been promised. The buyer should also ascertain whether any retired employees are still on the target’s payroll, as such liabilities may be significant in some cases.

Environmental Matters

The buyer should examine all environmental audit reports, environmental assessments and discharge permits to determine the target company’s compliance with PRC environmental protection laws and regulations. Quite a
number of Chinese companies consider the penalties for environmental violations cheaper than clean-up costs. Also, some local authorities may not enforce environmental rules stringently for local Chinese companies, but enforcement can suddenly increase when the local Chinese company becomes an FIE. So if environmental issues could be significant, the buyer should consider having professionals to do a complete environmental audit of the target company at an early stage of the due diligence process.

**Intellectual Property Matters**

The intellectual property rights of a target company (for example, trade names, trademarks, patents, copyrights, technologies, know-how) can be valuable assets of the target and in some transactions may be the buyer’s primary target. The buyer should review the target company’s ownership of its intellectual property rights and ascertain whether any of them are subject to encumbrances or third-party rights or interests. If the target company’s business depends on the use of intellectual property rights owned by third parties, the buyer should review license contracts to ensure that the target’s continued use of that intellectual property will not be a problem.

**Disputes/Litigation/Arbitration**

The buyer should determine if there is outstanding or threatened arbitration or litigation against the target, or other claims or disputes.

**Documentation and Agreements Required**

If the prospective buyer decides to continue with the acquisition after completing due diligence, definitive legal documentation will have to be prepared. The exact documentation required under PRC law will depend on the nature of the target and the structure of the transaction involved. (See Consents and Approvals above for the general documentation required for filing purposes.)

**Checklist for Provisions in the Acquisition Documents**

Besides the essential clauses setting out the equity purchased, the purchase price and the payment mechanism, the provisions required for an M&A acquisition document in China can vary greatly, depending on the nature of the transaction and type of assets. A tailor-made checklist should therefore be prepared for each transaction.
Protective Clauses for the Buyer

Regardless of the type of transaction adopted and the precise documents needed, the acquisition documents should include appropriate conditions precedent, as well as comprehensive and appropriate representations, warranties and undertakings. Though the purpose of due diligence is to ensure that there are no unexpected liabilities and that the target company’s business and assets are as represented, it is still advisable for the acquisition documents to have full and comprehensive representations and warranties with specific compensation provisions to cover any issues that may not have been disclosed or discovered in the due diligence.

PRC target companies and local JV partners sometimes resist these clauses, not because they have something to hide but just because they are not used to lengthy Western-style representations and warranties.

The buyer’s own expectations as to what amount of representations and warranties is appropriate will also affect these negotiations: buyers from common law jurisdictions typically want comprehensive and explicit representations and warranties, while buyers from civil law jurisdictions may rely more on statutory protections under PRC law and demand fewer explicit representations and warranties.

Closing

Completion or closing requirements depend on the nature and structure of the transaction. For example, in a direct equity acquisition, transfer of the target company’s registered capital is legally completed only after the relevant approval authority issues formal approval, and requires registration with the local AIC. But this requirement is not applicable in an indirect equity acquisition or asset acquisition. In the case of state-owned equity transfers, the transaction will have to be completed at a property rights exchange (see Approvals for Acquisitions above).

Subject to any applicable legal restrictions (e.g., full payment of the purchase price within certain periods under the M&A Regulations), the parties are generally free to decide the appropriate milestones for closing or completion of the transaction.
Joint Stock Limited Companies and Listed Shares

All listed companies in China (which may include FISCs) are in the form of joint stock limited companies. The CSRC is generally responsible for regulation of listed companies. PRC companies typically issue several types of listed shares.

- Domestic-listed shares (i.e., shares listed on a PRC stock exchange)
  - “A shares”: denominated in RMB; may be subscribed for and traded by Chinese entities, Chinese citizens, Qualified Foreign Institutional Investors (“QFII”) and foreign strategic investors
  - “B shares”: denominated in RMB; may be subscribed for and traded in a foreign currency by foreign entities, foreign individuals and Chinese citizens

- Overseas-listed shares are listed on a major stock exchange outside the PRC, e.g., “H shares” listed in Hong Kong, or shares listed on stock exchanges such as New York or London.

Investments by Foreign Entities

Purchase of A Shares by Foreign Strategic Investors

Qualified foreign strategic investors are permitted to buy A shares of listed companies.
To qualify as a foreign strategic investor, a foreign company, or its parent, must either own at least USD100 million or manage at least USD500 million of overseas assets. From 1 July 2006, foreign-invested HCs also qualify as foreign strategic investors.

Foreign strategic investors may acquire A shares through sale by agreement or issuance of new shares. The foreign investor’s initial investment must be at least 10% of the listed company’s total issued shares and the foreign investor may not sell any of its shares for three years.

**Purchase of A shares by QFIIs**

Foreign entities may also invest in A shares of listed companies through a QFII scheme. A QFII may invest in A shares listed on domestic stock exchanges, debt securities and other financial instruments, within its investment quota. But a single QFII cannot hold more than 10% of a listed company’s shares, and QFIIs together may not hold more than 20% of its shares.

**Investments by FIEs**

An FIE is also allowed to invest in PRC-listed companies if it has excess cash. FIEs, including FISCs, may buy A shares and non-traded shares of a domestic-listed company, subject to certain requirements and procedures. It is unclear whether there is a required holding period for A shares bought by an FIE. But if an FIE buys and sells A shares frequently, it may be deemed to be engaging in securities trading business and thus may go beyond its permitted scope of business, which in most cases will not include trading of securities.

**Insider Trading**

Insider trading of securities is prohibited under the Securities Law. In an M&A transaction involving a domestic listed company, a number of individuals will have inside information, and the prohibition of insider trading is relevant to them. Any person with inside information may not:

- buy or sell shares of the target company;
- disclose such information to another person; or
- advise another person to buy or sell shares of the target company.

Certain classes of individuals or entities (such as directors, supervisors, shareholders holding 5% or more of shares in the listed companies) are deemed to possess inside information under the Securities Law. The Securities Law
also further defines what constitutes inside information (e.g., plans for the takeover of listed companies and other major events). The CSRC may specify any additional class of persons as insiders, and any additional class of information as inside information.

**Acquisition of Listed Shares by Significant Investors**

Under the Securities Law, an investor whose shareholding reaches 5% or more of a listed company’s issued shares through trading on a stock exchange must within three days of acquiring that shareholding make a written report to the CSRC and the stock exchange, notify the listed company, and make a public announcement. During this period, the investor may not continue to buy or sell shares in the listed company. The investor must follow similar reporting and announcement procedures for each 5% increase or decrease in its shareholding in the listed company through trading on a stock exchange.

Under the Takeover of Listed Companies Administrative Measures revised 14 February 2012, an investor can take over a listed company by agreement, offer or on a stock exchange. Payment can be in cash, legally negotiable securities or other methods permitted by laws and regulations. The acquiring party must make a general offer to all shareholders of the target company if it intends to hold or control (either itself or acting in concert with other parties) over 30% of the target company’s outstanding shares, unless the CSRC waives this requirement. Except in limited circumstances, the investor may elect to make a total offer or a partial offer, as long as it expects to acquire at least 5% of the company’s issued shares pursuant to the partial offer.

The minimum offer price is the highest price the investor paid for shares of that class during the six months before the takeover notice.

Takeovers of domestic-listed companies by foreign investors must also comply with the Foreign Investment Catalog (see Summary of the PRC Foreign Investment Regime above) in terms of how much foreign participation is permitted in the underlying business.
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<td>National Development and Reform Commission</td>
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HONG KONG
DISCLAIMER

It should be noted that the material in this book is designed to provide general information only. It is not offered as advice on any particular matter, whether it be legal, procedural or other, and should not be taken as such. The laws and regulations summarized in this book are current as at 7 December 2012, except for those summarized in the “Public or Listed Company Considerations – General Disclosure Obligations” section which reflect amendments to the SFO and the Main Board Listing Rules (both terms as defined below) which take effect from 1 January 2013. The authors expressly disclaim all liability to any person in respect of the consequences of anything done or omitted to be done wholly or partly in reliance upon the whole or any part of the contents of this book. No reader should act or refrain from acting on the basis of any matter contained in it without seeking specific professional advice on the particular facts and circumstances at issue.

This may qualify as “Attorney Advertising” requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome.
Mergers and acquisitions ("M&A") are extremely common in Hong Kong and continue to represent a significant means by which corporations pursue the objectives of economic growth, expansion, diversification and wealth realization.

Broadly defined, a merger involves the absorption of one company that ceases to exist into another that retains its own identity and acquires the assets and liabilities of the former. Unlike certain other jurisdictions, Hong Kong does not currently provide for a simple, court-free amalgamation procedure for effecting the merger of companies (usually subject to compliance with statutory formalities and subject to approval by shareholders). Complex amalgamations may be effected through a court-sanctioned scheme of arrangement, though this is rarely used in practice. However, a new Hong Kong companies legislation was passed on 12 July 2012, and is tentatively scheduled to become effective in 2014. The new legislation includes a court-free statutory amalgamation procedure for intra-group companies. In the meantime, the economic results of a merger can be achieved through:

- the transfer of one company’s business assets to another company, followed by the liquidation or disposal of the transferor company;
- the establishment of a new company that acquires the assets of two or more entities which, following the transfer of assets, are liquidated or disposed of; or
- the transfer of one company’s ("Company A") shares to another company ("Company B"), followed by the liquidation of Company A and a distribution of its assets in specie to Company B.
The main sources of legal principles and regulations governing M&A in Hong Kong are:

- the common law of contract (which is heavily based on the English common law of contract) as interpreted by the courts of Hong Kong;
- specific Hong Kong legislation or regulations that apply depending upon the nature of the transaction and the relevant industry involved, including, where corporate entities are involved, the Companies Ordinance; and
- where publicly listed companies are involved, regulations such as the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, the Code on Takeovers and Mergers and decisions of the Securities and Futures Commission ("SFC"), as well as certain specific legislation.

Despite the handover of sovereignty of Hong Kong to the People’s Republic of China ("PRC") on 1 July 1997, Hong Kong maintains a different legal system from the PRC and has its own laws. This important principle of “One Country, Two Systems” is enshrined in the Basic Law of the Hong Kong Special Administrative Region, which came into effect on 1 July 1997, and serves as the constitutional document for Hong Kong. Among other things, the Basic Law ensures that Hong Kong’s previous capitalist system and way of life shall remain unchanged for 50 years and that the laws previously in force in Hong Kong, that is, the common law, rules of equity, ordinances, subordinate legislation and customary law, shall be maintained.
As in other jurisdictions, the acquisition of a business in Hong Kong may be structured either as a sale of shares or as a sale of assets (or as a combination of the two). More particularly, the buyer may purchase the shares of the company operating the business from its shareholders or purchase the assets of the business directly from that company. The following factors will be relevant in determining which method is more appropriate in any particular case.

**Simplicity** - A share acquisition is generally more simple to implement from both the seller’s and the buyer’s point of view. A share acquisition involves the transfer of ownership of only the shares in the target company which, as a matter of Hong Kong law, is a relatively straightforward process. It also provides continuity for the business for the buyer and a clean break for the seller. On the other hand, an asset sale involves the identification and transfer of title to specific assets or categories of assets, and as such is generally more complicated. The target’s assets will commonly include land and premises, inventory and work in progress, book debts, intellectual property rights, goodwill, insurance, leasing, hire purchase and other contracts, and plant and machinery. It will, therefore, be necessary to transfer each asset or category of assets from the target to the buyer by way of different conveyances, assignments and transfers that, in some instances, will also require consents from third parties not directly involved in the transaction. New permits or authorizations may also be required to carry on the business. The transfer of assets also raises additional concerns in relation to the employees of the business (see “Employment Issues” section).
Partial sale - A share acquisition may not be practical when only part of the target’s business is to be sold. In fact, one of the main advantages of an asset acquisition is that the buyer may pick and choose specific assets or liabilities to be purchased or assumed, leaving behind those assets and liabilities that it does not require.

Non-transferable assets - If the target has significant assets that are not capable of transfer, it may be possible to proceed instead by way of a share acquisition. For example, the target may possess non-transferable government licenses or have entered into agreements or contracts that are not assignable. However, if these licenses or agreements are also subject to restrictions on change of control, resorting to a share acquisition will not help.

Liabilities - A buyer of shares in the target company takes the company not only with all of its assets but also with all of its liabilities, including undisclosed or contingent liabilities. Though a buyer may seek protection against such liabilities by including representations and warranties in the purchase agreement (see the section on “Representations and Warranties”), in practice, the utility of this protection depends on the financial strength of the seller. The seller may also seek to limit his or her liability in the purchase agreement.

The buyer of assets will not generally inherit the target’s liabilities although in this respect the provisions of the Transfer of Businesses (Protection of Creditors) Ordinance (the “Transfer of Business Ordinance”) must be noted. Under the Transfer of Business Ordinance, the purchaser of a business, or part of a business, is deemed to be liable for all the debts and obligations arising out of the carrying on of the business by the vendor. Debts and obligations for which a purchaser could potentially be liable include sums of money owed by a vendor to its creditors; other obligations arising out of contract or tort, such as for breach of contract or product liability; liabilities to employees; or liabilities for unpaid taxes. It is possible to avoid this consequence by publishing certain notices, containing specified particulars that have the effect of barring any claim against the buyer in respect of which proceedings are not issued and served within one month of the notice.
It is common in an arm’s length transaction for the requisite notices to be published upon the signing of the relevant acquisition agreement relating to the transfer of the business. Completion then takes place after the expiry of the one-month period, subject to there having been no proceedings issued during that period or, if proceedings have been issued, that they have been dealt with to the buyer’s satisfaction. It is also possible to publish the notices after completion and rely upon contractual indemnities if any claims arise.

If the notice process is not followed, proceedings may be issued against the buyer at any time up to one year after the transfer. The seller’s liability to creditors is not affected by this procedure and any liability of the buyer is thus additional to that of the seller. It is important to note that the effect and requirements of this legislation do not affect indemnities and warranties between the seller and the buyer set out in the acquisition agreement.
Foreign Investment Restrictions

Hong Kong remains one of the least regulated jurisdictions in Asia. There are currently no investment approvals directed specifically towards foreign investors that are independent of industry regulation. In addition, as a general rule, there are no restrictions on levels of foreign ownership of Hong Kong companies.

However, regulatory controls apply to foreign ownership or control of companies in certain industries. For example:

- approval is required under the Broadcasting Ordinance if foreign ownership of a domestic free television program service licensee is to exceed certain shareholding thresholds: 2%, 6% and 10%;

- foreign ownership of a radio broadcasting company must not exceed 49% as regulated under the Telecommunications Ordinance ("TO"); and

- Certain telecommunications licenses may only be issued to Hong Kong companies (although there are no restrictions on foreign ownership of such companies).

Competition Law

After over a decade of public debate and close to 40 meetings of the Bills Committee to scrutinize the Competition Bill introduced by the government in July 2010, the Legislative Council has finally adopted the Hong Kong Competition
Ordinance (the “Competition Ordinance”) on 14 June 2012. The Competition Ordinance is expected to be enforced on a date set by the Secretary for Commerce and Economic Development. This date is expected to be either late 2013 or early 2014. The transition period is intended to give time to Hong Kong businesses to adapt to the new law, to establish the Competition Commission and the Competition Tribunal, and to prepare and issue relevant guidelines.

The Competition Ordinance contains procedures and concepts which have proven to be, in more mature competition law regimes, highly effective for detecting and penalizing infringements of competition law – in particular far-reaching investigative powers, the ability to impose potentially high fines, a leniency regime and a mechanism for allowing victims of anticompetitive conduct to bring actions for compensation.

The Competition Ordinance covers only two of the three main pillars of competition law, namely, anti-competitive agreements and abuse of market power. As explained below, it does not contain a comprehensive, cross-sector merger control regime.

• Under the First Conduct Rule, the Competition Ordinance focuses on enforcement against four types of anti-competitive agreements, namely, price-fixing, market allocation, output restriction (including in relation to real estate) and bid-rigging. Vertical agreements are not exempted per the law, but will benefit from a light-touch enforcement method.

• Under the Second Conduct Rule, the Competition Ordinance prohibits abuse of market power but does not define any safe harbor. The government, however, has indicated that a market share of more than 25% could, potentially, be considered as market power.

Before the Competition Bill was passed into law, telecommunications under the TO and broadcasting (under the Broadcasting Ordinance or “BO”) were the only sectors subject to competition law. Separate competition law regimes for these sectors will remain, though amendments to the TO and the BO will ensure consistency with the Competition Ordinance.

The Office for the Telecommunications Authority (“OFTA”), the Broadcasting Authority (“BA”) and the Commission will be empowered to enforce competition law in the telecommunications and broadcasting sectors, with the bodies signing a Memorandum of Understanding clarifying the responsibilities of each authority. This will likely give complainants a choice with respect to the authority to approach.
Currently, the Ordinance does not create a cross-sector merger control regime. The Ordinance also specifies that mergers cannot be reviewed under the so-called First Conduct Rules prohibiting anti-competitive agreements.

The only sector that is and will remain subject to a sector-specific merger control regime is that of telecommunications. The Ordinance has indeed maintained the existing provisions applicable to the telecommunications carrier licensees (including local and external fixed network operators and mobile network operators) under the TO. This may, however, change in a few years, when the government revisits the introduction of a comprehensive merger control regime. The merger provisions under the Ordinance are substantially similar to those already in force, though it is now clearer that even indirect or overseas transactions involving telecoms licensees and many minority acquisitions fall within the scope of the Hong Kong regime.

The M&A provisions in the TO provide the OFTA with the power to investigate M&A transactions that will result in any person having acquired (directly or indirectly) a beneficial ownership/control/interest exceeding certain thresholds of voting shares in a carrier licensee. The OFTA may direct the licensee to make changes to the M&A transactions to eliminate any anti-competitive effect. A licensee or any interested party may also approach the TA to seek prior consent for any proposed M&A transactions.

In accordance with its obligations under the TO, the OFTA has issued the Guidelines on Mergers and Acquisitions in Hong Kong Telecommunications Markets. The guidelines specify the factors that the OFTA will take into account in analysing M&A transactions that may raise competition concerns and the procedures the OFTA will follow in investigating such M&A transactions. Restrictions on cross media ownership also apply in relation to the telecommunications and broadcasting industries. Sections 13G-13I of the TO provide for the control of cross-media ownership, ownership by non-residents and restrictions on licensees exercising control of disqualified persons in connection with sound broadcasting licensees. Part 2 of Schedule 1 of the Broadcasting Ordinance provides for the control of cross-media ownership and restrictions on licensees exercising control of disqualified persons in connection with TV operator-licensees.

To a limited extent, the common law principles concerning the unenforceability of contractual provisions in restraint of trade can also influence market-dominating activities.
Exchange Controls

Currently, Hong Kong has no controls on the movement of foreign exchange. Similarly, there are no restrictions on investment or repatriation of capital or remittance of profits or dividends to or from a Hong Kong company and its shareholders. In certain circumstances, withholding tax may be payable on royalty payments. Subject to the restrictions under the Companies Ordinance concerning the maintenance of a company’s capital, there are no limits on the amount of profits which may be remitted to a foreign investor.

Specific Industry Regulation

In certain industries, the consent of the relevant regulatory body is required for a change of ownership, the acquisition of even a minority interest, or the disposal or amalgamation of the regulated business. Such businesses include:

- banking, restricted licensed banking or deposit taking (Banking Ordinance);
- insurance companies (Insurance Companies Ordinance);
- securities dealers and securities investment advisers (Securities and Futures Ordinance); and
- radio and television broadcasting (TO and the BO).

It should be noted that, with only a few exceptions, these merger approvals apply equally to foreign and local investor entities.

Public or Listed Company Considerations

These considerations are dealt with in a subsequent section of this guide.

Non-Regulatory Consents and Approvals

As in other jurisdictions, M&A transactions in Hong Kong may also require that consents, approvals or waivers be obtained from non-regulatory third parties under the constituent documents as well as agreements and contracts of the target company. For example, in an acquisition of some but not all of the shares of a company, the consent of the other shareholders may be required to waive pre-emptive rights or other restrictions on transfer under the Articles...
of Association or bylaws of the target company. In an acquisition of assets, the target’s constituent corporate documents should also be reviewed to ascertain whether the disposal of assets requires consent from all or some of its shareholders. The same considerations apply to shareholders’ agreements entered into by the shareholders of the target, which may contain provisions restricting share transfers or asset disposals.

Third party contractual consents may also be required from creditors, landlords, debenture holders, mortgagees and other contracting parties as a result of the transfer of the assets comprising a business or the change in control of a company operating a business.

The parties will also need to consider the procedures for transferring the licenses, consents and permits that may be required for the conduct of a business in Hong Kong or the obtaining of new licenses, consents and permits by a buyer where there is an acquisition of assets.
Jurisdictional Tax

In a share acquisition, a target company will retain the same tax basis for its assets regardless of the price paid for its shares. The step-up of capital asset values for depreciation purposes will be relevant in an asset transaction but not in an acquisition of shares.

The tax losses of a company may be carried forward indefinitely and set off against the company’s future profits. However, such tax losses cannot be carried back and set off against previous income. Tax losses will not be lost following the sale of the shares of a company unless the sole or dominant purpose of the acquisition is to acquire the tax losses (this could be evidenced by a change in the nature of the company’s business). Hong Kong law does not permit a company’s tax losses to become available to related companies, even where the common shareholding is 100%.

Gains on the disposal of a capital asset are exempt from profits tax (income tax). However, if a gain is made by a person (the definition of which includes corporations) who carries on business in Hong Kong, and derives that gain from a Hong Kong source through such business, profits tax will be chargeable. Whether a profit is Hong Kong-sourced will be determined on the basis of the location of the operations generating the profit, termed the “operations test”.
Whether a gain is capital in nature (tax-exempt) or revenue in nature (taxable) is a question of fact. If, for example, a Hong Kong shareholder trades in local securities, the gains from the sale of the shares may be subject to Hong Kong profits tax as trading profits. If the shareholder is located outside Hong Kong, but carries on business in Hong Kong (itself or through an agent), Hong Kong profits tax may still be chargeable on any profits having a source in Hong Kong.

Interest income will be taxed if it is sourced from Hong Kong. In most situations, the source of interest on simple money loans is determined by the Hong Kong tax authorities (the “Inland Revenue Department”) as the location where the credit is first provided to the borrower.

No withholding tax is charged on dividends or interest payments, whether such payments are made to Hong Kong residents or overseas payees.

Where assets are being acquired, it may be necessary for the seller and the buyer to agree on an apportionment of the purchase price between the different types of assets being transferred, customarily: trading stock; plant and machinery; industrial buildings; commercial buildings; land; patents; trademarks and designs; and goodwill. Generally, the parties have a degree of discretion in negotiating such values although the Inland Revenue Department may reallocate values in respect of certain classes of assets.

In general terms, in order to balance the seller’s desire to minimize liability to Hong Kong profits tax and to avoid a clawback of depreciation allowances, and the buyer’s desire to achieve a step-up in asset values for depreciation purposes, the seller will want to attribute low values to trading stock, plant and machinery, and buildings. The seller will usually wish to attribute higher values to goodwill and other non-depreciable assets such as intellectual property rights. The buyer would generally prefer to attribute higher values to inventory and depreciable assets in order to increase its subsequent tax benefits.

An exception to this general position is the sale of assets by a company with available tax losses. In such a situation, a seller may agree to higher values in order to utilize tax losses that would otherwise be lost following the asset sale and liquidation of the company.

Hong Kong does not impose value-added tax or goods and services tax.

It should be noted that expenses which are revenue in nature may be deductible for profits tax purposes, whereas expenditure which is capital in nature is not. As with the nature of gains explained above, the nature of expenditure is also a question of fact. Further, in order to be deductible, a revenue expenditure must be incurred in the production of profits which are chargeable to profits.
tax. Interest is deductible only if it meets certain criteria, which are designed to prevent deductions being granted for interest payments where the receiver is not assessable to profits tax in Hong Kong.

In addition to domestic tax considerations, Hong Kong has concluded comprehensive double taxation agreements with the Austria, Belgium, Brunei, People’s Republic of China, the Czech Republic, France, Hungary, Indonesia, Ireland, Japan, Jersey, Kuwait, Liechtenstein, Luxembourg, Malaysia, Malta, Mexico, The Netherlands New Zealand, Portugal, Spain, Switzerland, Thailand, United Kingdom, and Vietnam.

The treaty with the PRC includes several important and beneficial provisions including a limited capital gains tax provision and reduced withholding tax rates on dividends, interest and royalties. The potential application of the treaty should be considered for all M&A transactions involving Hong Kong companies with PRC investments or vice versa.

**Transactional Tax**

**Stamp Duty**

Transfers of shares in Hong Kong-incorporated companies (or companies incorporated outside Hong Kong with their issued shares recorded on a register maintained in Hong Kong) are subject to stamp duty, currently calculated at a rate of 0.2% of the value of the shares or the purchase price paid, whichever is greater. Where the amount of stamp duty payable on a company acquisition is likely to be significant, certain techniques (such as a fresh allotment of shares or the reclassification of existing shares) may be adopted to minimize the duty. If such techniques involve steps that have no commercial or business purpose, the Collector of Stamp Revenue may seek to apply anti-avoidance principles to disregard the non-commercial steps. There is an exemption available for shares that are transferred between companies with a common shareholding of 90% or more (amongst other conditions). An application must be made to the Collector of Stamp Revenue in order to obtain this exemption. Stamp duty must be paid before the transfer of shares can be registered in the books of the target company and within the time periods specified in the Stamp Duty Ordinance.

Capital duty was previously payable with respect to increases in the authorized share capital of a Hong Kong company and the issue of shares at a premium. As of 1 June 2012, capital duty has been abolished in Hong Kong.
In the absence of a tradition of militant, politically-organized trade unions or employee organizations, employment issues are rarely problematic and have not to date presented significant impediments to M&A in Hong Kong. There are, however, certain Hong Kong employment law issues relevant to M&A.

Where a transaction takes the form of an acquisition of shares in a company with employees, there are unlikely to be significant employment law issues as the underlying employment contract (and employee benefits generally) between the target company and its employees will usually be unaffected by the change in control of the employer. In this context, it is really a matter for the buyer to identify the liabilities associated with the labor force and possibly also to make appropriate arrangements for the transfer of benefits or establishment of an appropriate pension or retirement scheme. The contracts of key senior personnel should be checked for any change of control provisions. Due diligence should be undertaken to ensure that potential liability for past acts and omissions is known.

The position is a little more complex in the case of a transfer of the assets comprising a business. In this situation, Hong Kong law provides that the contracts of the employees who are employed by that business do not automatically transfer to the buyer. Existing contracts of employment must therefore be terminated and new contracts entered into with the buyer or a related entity. Technically, the employees will be made redundant by the transfer and it is important to take steps, to the extent possible, to minimize the employer’s potential liability to make payments to employees in this situation.
Generally, employees have no rights as regards security of continuing employment. Under current legislation, an employer will be entitled to terminate employment either by the giving of contractual notice or the making of a payment in lieu of notice. Exceptions to the right to terminate may exist in cases involving union membership, sick leave, maternity leave, pregnancy or industrial accidents. This freedom to terminate is also slightly restricted by anti-discrimination legislation and restrictions on unfair dismissal. Current anti-discrimination legislation in Hong Kong comprises the Sex Discrimination Ordinance, the Family Status Discrimination Ordinance, the Disability Discrimination Ordinance and the Race Discrimination Ordinance. This legislation makes it unlawful to discriminate on grounds of sex, pregnancy, marital status, family status, disability or race.

Employees must be given the length of notice of termination required under their contracts or, where relevant, any longer period as provided for in the Employment Ordinance. If no such notice is given, “wages” (as defined under the Employment Ordinance) in lieu of notice will be payable by the employer. The minimum period of notice that may be agreed under the Employment Ordinance is seven days and continuous contracts of employment are, in the absence of express agreement to the contrary, treated as requiring one month’s notice. Wages must be paid to the date of termination and payment for accrued annual leave may also be needed. These payments are based on average wages calculated by reference to the 12 full calendar months immediately preceding the transfer date. “Wages” include salary and most allowances and commissions. In addition, a pro rata bonus may also be payable, depending on the nature of any bonus plan.

In order to avoid liability to make severance payments to employees on the transfer of a business, the offer of new employment must be given by the buyer not less than seven days before the date of the employees’ transfer. The new terms of employment must either be identical to those under the employees’ existing employment or constitute an offer of suitable employment on terms no less favorable to the employees than those under which they were previously employed. The new employer must agree to recognize the employees’ previous service. It is common practice for the termination and offer of new employment to be combined in a joint letter sent by the seller and the buyer, or to be made in separate letters from the seller and the buyer to be given to employees at the same time. Typically, the employee’s consent to shorter contractual notice to the transfer is also contained in the transfer letter. As mentioned above, the notice period cannot, however, be less than seven days.
If the employee refuses an offer on these terms or has less than two years of service, no statutory severance is due. Similarly, where the employee accepts the offer, no statutory severance will be due.

If there is no liability to make any severance payment to an employee, that employee may still be entitled to a long service payment if he or she has at least five years’ service and decides not to accept the offer of new employment from the buyer.

The employer is entitled to deduct from a severance or long service payment any gratuity based upon length of service, or any retirement scheme payment attributable to the employer’s contributions, paid to the employee. Similarly, an employer may reduce the amount of any gratuity or relevant retirement scheme payment payable to an employee, by the amount of any severance or long service payment made to such employee. However, these set-off provisions do not apply to an employee’s own contributions, including any sum payable by way of interest thereon. The existing cap on both severance payments and long service payments is HKD390,000 for each employee.

In summary, if, on a transfer of assets or business, the employees receive the requisite notice or payment in lieu of notice and are offered identical or no less favorable terms of re-employment by the buyer at least seven days before transfer, but decide not to accept the offer from the buyer and their employment is terminated by the seller, the legal exposure of the seller will, in normal circumstances, be limited to a long service payment, if applicable, plus accrued wages and untaken annual leave only. If the employees are entitled to a contractual bonus, a pro rata portion will also be payable.

Since 1 December 2000, it has been mandatory for Hong Kong employers to participate in a mandatory provident fund scheme and to make contributions in accordance with the Mandatory Provident Fund Schemes Ordinance. Under this ordinance, the maximum amount of mandatory contributions currently payable by the employer in respect of each employee is HKD1,250 per month and the maximum amount of the monthly mandatory contributions currently payable by each employee is HKD1,250. Alternatively or concurrently, an employer may operate an occupational retirement scheme (MPF-exempted ORSO scheme) that has been granted an exemption certificate under the Mandatory Provident Fund Schemes (Exemption) Regulation (the “Exemption Regulation”). It is therefore possible that the relevant employees may be members of the MPF-exempted ORSO scheme and/or a mandatory provident fund (“MPF”) scheme of the seller. It is also possible that the employees may participate in an ORSO scheme (not being granted an exemption certificate under the Exemption Regulation) as a top-up scheme in addition to their participation in an MPF-exempted ORSO scheme or MPF scheme.
The treatment of the retirement scheme arrangement of the relevant employees, be it in the context of acquisition of shares or transfer of assets, would primarily depend on: (a) the wishes of the seller and those of the buyer; (b) the scheme(s) the relevant employees are participating under their employment with the seller, and the benefit structure under such scheme(s); and (c) the schemes the buyer operates or otherwise participates in.

In relation to (b), particularly in asset transfer cases, considerations would include: (i) where the relevant employees are participating in the seller’s MPF scheme, whether the seller has been making voluntary contributions in respect of them and if so what vesting scale (if any) is applicable to the benefits due to such voluntary contributions and whether (and how) the benefits can be transferred to another scheme; (ii) where the relevant employees are participating in the seller’s MPF-exempted ORSO scheme, whether (and how) the benefits can be transferred to another scheme.

In the case of (c), where the buyer wishes to enrol the employees to its MPF-exempted ORSO scheme, regardless of which type of scheme the relevant employees are participating under their employment with the seller, the buyer will be required to give the relevant employees an option to choose between joining an MPF scheme and joining the seller’s MPF-exempted ORSO scheme in accordance with the Exemption Regulation.

It will be necessary to consider the constitutive documentation of the relevant retirement scheme(s) and, where applicable, the Mandatory Provident Fund Schemes Ordinance and the related regulations to determine the restrictions and requirements in connection with the membership of the relevant employees and the transfer (if applicable) of such employees’ benefits under the seller’s scheme(s) to the buyer’s retirement scheme(s).

The situation will be fairly straightforward in a share acquisition context where the relevant employees are participating in an MPF scheme to which only mandatory contributions are paid by and in respect of them. In such case, probably no change will need to be made to the employees’ retirement scheme arrangement, although where the acquisition triggers any change of name of the employing entity, the employing entity may need to notify the trustee of the MPF scheme of any such change. Likewise, again, in the context of a share acquisition, where the relevant employees are in a standalone MPF-exempted ORSO scheme (i.e., the seller is the only employer in it), unless the buyer wishes to change the retirement scheme arrangement of the employees, the employees may continue participation in the MPF-exempted ORSO scheme after the acquisition. But, if following the acquisition, the name of the employing entity and/or that of the MPF-exempted
ORSO scheme may change, the employing entity will need to notify the Mandatory Provident Fund Schemes Authority within the statutorily prescribed timeframe.

Apart from the above, extra care should be taken where the relevant employees participate in an MPF-exempted ORSO scheme in respect of their employment with the seller which is a defined benefit scheme or contains benefits forfeited to the scheme upon bankruptcy of the employees.
Memorandum of Understanding/Letter of Intent

Hong Kong follows generally accepted international practices for the consummation of M&A transactions. This will ordinarily involve an initial phase of preliminary discussions between the seller and the buyer that are intended to identify the commercial and legal parameters for the transaction. Often, these parameters will be recorded in a heads of agreement, letter of intent or memorandum of understanding that may or may not be expressed to be legally binding. Even if the parties’ understanding as to the parameters of the transaction is not intended to be legally binding, it is common for an exclusivity commitment to be agreed and also for the buyer to undertake certain confidentiality obligations with respect to information obtained concerning the target and its business.

The next phase of the transaction ordinarily involves due diligence investigations of the target company and its assets and liabilities. In addition to due diligence of financial and accounting matters, legal due diligence is also required.

The final phase usually involves the preparation, negotiation and execution of an appropriate sale and purchase agreement and any other necessary collateral agreements, such as employment agreements or specific indemnities.

In larger private transactions or deals involving publicly listed groups, it is common for a tender process to be adopted by the seller. This will usually involve the seller’s financial advisers preparing an information memorandum describing the assets to be sold and circulating this document, on a strictly confidential basis, to a limited number of selected parties. Recipients are invited to submit
an indicative (generally non-binding) offer within a specified time period. After receiving these offers, the seller and its advisers shortlist a smaller number of possible buyers who are given access (usually by a data room procedure) to due diligence materials and the seller’s proposed sale and purchase documentation. A final bid is invited, after which time the seller will usually choose one party with whom to proceed to negotiate and sign the transaction documents.

**Due Diligence**

Broadly speaking, the purpose of due diligence is to obtain financial, commercial, legal and administrative information about the target and its business. Due diligence can be conducted in various ways. Searches of publicly available information may be made with the relevant government authorities (e.g., the Hong Kong Companies Registry, the Hong Kong Land Registry, the Registry of Trademarks, the Official Receiver’s Office and the Hong Kong Courts in respect of litigation and winding-up proceedings).

In addition, the buyer will customarily send a list of enquiries and a documents checklist to the seller and request that the seller answer them or produce the relevant documents in order to obtain information about the company or assets to be acquired. In answering such enquiries, the seller must be careful to avoid any misrepresentation that may, subject to the terms of the final agreement, subsequently be relied upon by the buyer to rescind the agreement and claim damages. The buyer may also instruct a firm of accountants to carry out an investigation into the target’s affairs and prepare an accountant’s report. The buyer will often request meetings with the senior management of the target business at which further information can be sought.

In some cases, a buyer may also wish to instruct experts to value specific assets owned by the target, such as real property.

Consistent with international practice, sellers in Hong Kong also make use of physical or electronic data rooms where certain limited information is provided for review by the buyer and its advisers, usually for a fixed time and subject to rules and restrictions.

On the basis of the information gathered in the course of due diligence, the buyer will decide whether the transaction is to proceed and, if so, whether certain of its parameters are to be modified (for example, by revising the purchase price, inserting additional warranties or excluding certain assets or liabilities from the acquisition). From a buyer’s perspective, the importance of effective due diligence cannot be overstated.
However, no investigation, no matter how thorough, is able to reveal all hidden liabilities and adverse claims against the company or the assets to be acquired. In practice, time constraints, confidentiality requirements and other factors may limit the scope of the investigation. Accordingly, it is prudent for buyers to protect themselves by insisting that the seller or the seller’s related parties give certain representations and warranties on the assets or the company to be acquired.

Representations and Warranties

The common law rule of *caveat emptor*, or buyer beware, still has widespread application to the acquisition of shares or assets in private companies (and to a lesser extent, public companies) in Hong Kong. In general (absent contractual provisions), a seller will not be liable for non-disclosure of relevant information. In respect of a share acquisition, there is no statutory protection in favor of the buyer. In respect of an asset acquisition, certain “sale of goods” legislation sets out limited implied warranties. These warranties are not extensive in scope and in any case apply only to physical assets and do not cover other important assets of the target such as real property, receivables and intellectual property rights. Furthermore, provided that neither party to the contract is a “consumer” within the meaning of the relevant legislation, these implied warranties can be excluded.

In order to protect its investment, a buyer will usually require comprehensive representations and warranties in the acquisition agreement. However, claims arising from a breach of warranty are only ultimately enforceable by litigation that can be both costly and time-consuming. Recovery of damages will also depend on the creditworthiness of the seller (or other persons liable for the warranties, if any) at the time the judgment is enforced. Some liabilities may not reveal themselves until after the representations and warranties have expired. Therefore, pre-contractual due diligence investigations remain a critical aspect of M&A transactions in Hong Kong.

In a share acquisition, the representations and warranties will generally cover the target’s accounts, taxation, corporate matters, title to assets, trading, properties, intellectual property rights, plant and equipment, stock and work in progress, vehicles, insurance, employment matters, environmental matters, banking and finance, regulatory and tax compliance, litigation, and the accuracy and completeness of information provided by the seller.
In an acquisition of assets, the representations and warranties tend to be less extensive. They will generally include ownership and condition of assets, accounts of the business, trading activities, employees, and other specific issues regarding the business to be transferred.

Where representations and warranties are given, there will normally be significant negotiation over the limits of the seller’s liabilities. The seller will usually seek to negotiate a cap or fixed maximum on the total amount of claims, provisions restricting small claims, and limits on the time within which any claims must be brought. It is conventional practice in Hong Kong to distinguish between the time limit for claims under the commercial warranties and the time limit for claims under the tax warranties. In Hong Kong, the buyer usually gets protection against taxation liabilities by a tax indemnity, in addition to detailed tax representations and warranties. For acquisitions of shares or assets where environmental issues may arise (such as where industrial properties are acquired), it is not uncommon for environmental liabilities to be subject to a separate deed of indemnity.

The seller may seek to qualify the representations and warranties contained in the agreement by issuing a disclosure letter. The disclosure letter will list all information and documents already disclosed to the buyer. It will operate to exclude liability on the part of the seller regarding the specific matters disclosed, as the buyer has or is deemed to have knowledge of such matters. There will usually be significant negotiation of the terms of the disclosure letter. Apart from the representations and warranties, however, the agreement may contain indemnities over matters where the seller is liable notwithstanding that the buyer has knowledge of them. Such indemnities will generally cover taxation and environmental liabilities (if applicable) but may also be extended to matters for which the parties have agreed that the buyer should not, in any event, be liable.

**Acquisition Agreement**

Completion of a buyer’s due diligence investigation may precede the negotiation and signing of relevant acquisition agreements or may continue after the signing of such agreements with the satisfactory completion of due diligence being a condition precedent to completion of the transaction. The choice between these alternative approaches is a matter for negotiation between buyer and seller.
It is common practice for the agreement relating to the acquisition of shares or assets in the target to be drafted by the lawyers for the buyer. This, however, is a convention from which there are occasional departures. Where an acquisition occurs by way of subscription for shares (for tax or other reasons), the appropriate subscription agreement will ordinarily be drafted by the target company’s lawyers. The terms of the agreement will, of course, be the subject of detailed negotiation (see the section focusing on “Principal Provisions of an Acquisition Agreement”).

Where it is necessary to obtain regulatory or other consents or approvals before completion or for the buyer to complete further due diligence (e.g., an audit) after signing the agreement, then signing of the agreement and completion of the transaction will not be simultaneous. There will be a period of time between signing and completion during which the conditions precedent are to be satisfied. This gives rise to questions for the parties, such as who is responsible for the fulfilment of each condition, who controls the business of the target company between signing and completion, and whether the buyer or the seller takes the risk of there being adverse changes in the business of the target company between signing and completion.

Principal Provisions of an Acquisition Agreement

Customarily, the principal provisions of the acquisition agreement will cover the following matters:

- Agreement to buy and sell
- Price and price adjustments
- Consideration:
  - retention/deferral/escrow of purchase price; and
  - security for any deferred part of purchase price.
- Conditions precedent:
  - what they are;
  - responsibility for fulfilment; and
  - conduct of business pending completion/closing.
- Completion/closing obligations:
  - transfer of title to shares/assets;
  - change of directors/officers;
- new employment contracts for key staff;
- repayment of inter-company debts;
- payment of purchase price; and
- clearance from relevant authorities, if applicable.

• Warranty provisions:
  - seller’s representations, warranties and indemnities;
  - limits on seller’s liability;
  - security for seller’s liability;
  - buyer’s representations, warranties and undertakings; and
  - indemnities in respect of key identified potential liabilities (e.g., tax and environmental matters).

• Post-completion obligations, including, for example:
  - transfer of pension schemes; and
  - unwinding of arrangements with related parties.

• Confidentiality and public announcements

• Restriction on competition by seller

• Costs and expenses

• Governing law and dispute resolution mechanism

The sale and purchase agreement will address the manner of completion (or closing) of the sale of shares or assets in detail. For example, in the case of a share sale, the completion provisions will include, amongst other things:

• transfer of title to the shares will take place by the delivery of a properly executed instrument of transfer and bought and sold notes and the original share certificate, which is prima facie evidence of title, followed by the stamping and registration of the transfer in the company books of the target (which normally will require the passing of a board resolution of the target where the target is a private limited company); and

• the manner of settlement of the purchase price will usually be done by telegraphic transfer or delivery of a banker’s draft at completion.
As well as the mechanics for passing title to the shares to the buyer, the sale and purchase agreement will also usually contain provisions to ensure that the buyer obtains practical control of the target at completion. In most cases, this will involve obtaining resignations from outgoing directors and other company officers (coupled with waivers of claims for loss of office). In the absence of such resignations, the buyer may find it difficult to remove unwanted officers before the expiration of their term of office. The buyer should also ensure that the outgoing shareholders hold a shareholders’ meeting to appoint the buyer’s nominees to the board of directors of the target company.

In addition, the buyer may want key directors or staff to sign revised employment contracts at completion. If these are, in any way, aimed at “tying up” key personnel by fixed-term contracts, long periods of notice or post-termination restrictions on competition, their effect may be limited by law and each case should be reviewed separately. The effect that changes to terms and conditions will have on the seller’s liability to make severance payments should also be considered. For guidance on this issue, please refer to the section on “Employment Issues” above.

The completion mechanics should also address any steps necessary to unwind existing links between the target company and the seller (e.g., the repayment of debts owing between the target and the seller, and the release of guarantees given by the seller for the target). However, where there are assets or facilities shared by the seller and the target (e.g., premises, accounting systems or distribution arrangements), it may not be practical to deal with these at completion. There may need to be transitional arrangements to allow a period of gradual disengagement after completion of the sale.
Public or Listed Company Considerations

Additional legal and regulatory issues arise where the securities of the target company are listed on the Main Board of The Stock Exchange of Hong Kong Limited ("Stock Exchange") or the Growth Enterprise Market of the Stock Exchange ("GEM"); or the target is a member of a Hong Kong-listed group; or either the seller or buyer is a Hong Kong-listed company.

Acquisition of a Substantial Shareholding

Acquisitions of substantial (i.e., 5% or more, or 10% or more, depending on the context) or controlling (30% or more) interests in Hong Kong-listed companies are principally regulated by a number of ordinances and codes, including:

- The Securities and Futures Ordinance ("SFO")
- The Companies Ordinance
- The Hong Kong Code on Takeovers and Mergers ("Takeovers Code")
- The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Main Board Listing Rules") and the Rules Governing the Listing of Securities on GEM ("GEM Listing Rules"); collectively with the Main Board Listing Rules, "Listing Rules"

The SFO came into effect on 1 April 2003. It consolidated and replaced much of the previous securities legislation, including the Securities (Disclosure of Interests) Ordinance (repealed) and the Securities (Insider Dealing) Ordinance (repealed).
Under Part XV of the SFO, the acquisition of an interest of 5% or more of the voting shares of a Hong Kong-listed company must be disclosed, on a prescribed form, to the Stock Exchange and the listed company. An “interest” has been extended to include an interest in the underlying shares of equity derivatives. Once the 5% interest threshold is reached, an acquisition of a 1% or more short position in the underlying shares of equity derivatives would also trigger a separate disclosure obligation. A statement of the amount of the interest and short position must also be disclosed in the listed company’s annual and interim accounts.

The provisions for determining whether there has been an acquisition of an interest in shares are drafted in broad terms. A person may be taken to be interested in the shares held by another person if the following factors are present (referred to as a concert party agreement):

- There is an agreement [written or verbal as long as this is legally binding, or simply a mutuality of undertaking/expectations] for the acquisition by one or more of the parties of interests in the shares of the target company.

- That agreement:
  - imposes obligations or restrictions on one or more of the parties with respect to use, retention or disposal of their interest in the target company’s shares; or
  - provides for a loan (or security for a loan) by a controlling person (as defined under the SFO) or a director of the target company for the acquisition of an interest in the target company’s shares.

- An interest is actually acquired pursuant to the agreement.

Insider Dealing

In the course of a transaction involving a Hong Kong-listed company, a number of parties (such as directors, certain employees and legal and financial advisers) will knowingly be in possession of price-sensitive information concerning the target company, its officers and shareholders. Such persons must be extremely careful to avoid dealings in the relevant securities or disclosing price-sensitive information to other parties who then deal in the securities, since such conduct is likely to constitute insider dealing in contravention of the prohibitions set out under Parts XIII or XIV of the SFO.
There are also provisions of the Takeovers Code and the Listing Rules that restrict dealings in a target company’s securities before and during the period of a general offer and, where the general offer does not proceed, after the termination of discussions but before such termination is announced.

**Takeovers Code**

Acquisitions of controlling stakes in Hong Kong public companies are regulated principally by the SFC under the Takeovers Code as well as relevant provisions of the Listing Rules and the Companies Ordinance.

The Takeovers Code applies to both public companies in Hong Kong and companies with a primary listing of their equity securities in Hong Kong. Issues will also arise under the Takeovers Code when a buyer acquires another company, including a foreign company, which has effective control over a Hong Kong public company. This extended application of the Takeovers Code is based on what is known as the “chain principle” set out in Paragraph 8 of the Notes to Rule 26.1 of the Takeovers Code.

The primary purpose of the Takeovers Code is to ensure fair treatment for shareholders who are affected by takeover and merger transactions. A separate code with a similar purpose applies to share repurchases involving Hong Kong public companies. Both codes seek to achieve fair treatment by requiring equality of treatment of shareholders, mandating disclosure of timely and adequate information to enable shareholders to make informed decisions on the merits of an offer, and ensuring that there is a fair and informed market in the shares of companies affected by takeover and merger transactions.

The Takeovers Code is a voluntary code that does not have the force of law.

**Mandatory General Offer Obligation**

Generally, a buyer may build its stake in a target company either by acquiring a significant shareholding from an existing substantial shareholder or by making direct purchases in the market. Once a buyer has obtained an interest of 5% or more of the voting shares of a Hong Kong-listed company, public disclosure under Part XV of the SFO will be required (discussed above).
The threshold shareholding of particular significance under the Takeovers Code is 30%. Under Rule 26.1 of the Takeovers Code, a mandatory offer (also referred to as a general offer) to all shareholders must be made where:

- any person acquires shares which, when taken together with the shares already held by the buyer, and/or the shares held or acquired by any persons acting in concert with the buyer, represent 30% or more of the voting rights of a company; or
- any person who, together with parties acting in concert with it, holds not less than 30%, but not more than 50% of the voting rights of a company, and acquires (whether alone or together with concert parties), in any period of 12 months, additional shares carrying more than 2% of the voting rights of a company.

The majority of questions concerning interpretation of the Takeovers Code arise in relation to the concept of persons “acting in concert”. The definition of acting in concert contained in the Takeovers Code is drafted in broad terms but does set out a list of persons who are presumed to be acting in concert unless the contrary is established.

A general offer must be for cash or a cash alternative at not less than the highest price paid by the buyer for shares in the target company within the preceding six-month period.

Where a conditional offer is made and lapses, or is withdrawn because the conditions are not met, the offeror is subject to a 12-month restriction in making or announcing subsequent offers whereby the offeror will increase its shareholding in the target to 30% or more.

Where an issue of new shares (as opposed to sale of existing shares) as consideration for an acquisition, or a cash subscription, or the taking of a scrip dividend, would otherwise result in an obligation on the buyer to make a mandatory offer under Rule 26.1 of the Takeovers Code, the Executive of the SFC ("Executive") will normally waive the obligation if there is an independent vote (by shareholders who are not involved in, or interested in, the transaction) at a shareholders’ meeting.
Announcements

It is absolutely fundamental that secrecy be maintained in respect of all confidential information before an announcement of an offer or proposed offer is made. Rule 1.4 of the Takeovers Code requires that all persons who have confidential information, particularly if it is price-sensitive, concerning an offer or contemplated offer are required to take the greatest care to maintain its confidentiality. Of course, this obligation must be reconciled with the various announcement and disclosure obligations set out in the Takeovers Code that require all persons concerned in takeovers to make full and prompt disclosure of all relevant information and take every precaution to avoid the creation or continuance of a false market.

Rules 3.1, 3.2 and 3.3 of the Takeovers Code set out certain specific instances in which, prior to the despatch of a formal offer document relating to a general offer (and before the acquisition of shares that gives rise to the obligation to make a general offer), announcements are required to be made by the target company, the offeror and/or the seller. An announcement is required (among other specific instances):

- when the board of the target company is notified from a serious source of a firm intention to make an offer, irrespective of the attitude of the board to the offer;
- when, following an approach to the target, the target is the subject of rumor or speculation or there is undue movement in its share price or in the volume of share turnover, whether or not there is a firm intention to make an offer;
- when, before an approach has been made, the target is the subject of rumor or speculation, or there is undue movement in its share price or in the volume of share turnover, and there are reasonable grounds for concluding that it is the potential buyer’s actions (whether through inadequate security, purchasing of shares in the target or otherwise) that have led to the situation;
- when negotiations or discussions are about to be extended to include more than a very restricted number of people (i.e., individuals in addition to the representatives of the seller, buyer and target who need to know and their immediate advisers); or
- when there are negotiations or discussions between a potential offeror and the controlling shareholder and the target is the subject of rumor or speculation or there is undue movement in its share price or in the volume of share turnover, and there are reasonable grounds for concluding that it is the potential seller’s actions (whether through inadequate security or otherwise) that have led to the situation.
An element of judgment is required in determining when a “firm intention to offer” is received from a “serious source” and reference to the Executive at an early stage is advisable.

There is often considerable debate as to whether a letter of intent (whether binding or non-binding) should be entered into between the seller and the buyer (or its financial adviser). Where a letter of intent is entered into, even if it contains only brief details of the proposed transactions and is subject to numerous conditions, it is arguable that a formal announcement concerning the letter of intent is required under Rules 3.1, 3.2 or 3.3 of the Takeovers Code. Unless announced publicly, agreements and letters of intent relating to an offer or possible offer to which the buyer is a party should be disclosed to the Executive (Note 1 to Rules 3.1, 3.2 and 3.3 of the Takeovers Code).

As a general rule, the more detail in the letter of intent or agreement concerning the proposed terms relating to the transaction, the more likely it is that an announcement will be required. The signing of the letter of intent will be resisted, for example, by the seller where there are concerns that the transaction may not proceed given the likelihood of an adverse market reaction, or reaction from employees and customers, to a subsequent announcement (which would be required) in that event.

As the transaction proceeds, it is also necessary to ensure that subsequent announcements are made in relation to takeover-related matters. The most notable of such announcements is the formal announcement of the firm intention to make an offer required under Rule 3.5 of the Takeovers Code. This detailed announcement must include the matters specifically set out in Rule 3.5 and is customarily made immediately after the relevant acquisition agreements are signed.

The primary responsibility for making announcements under the Takeovers Code before an approach is made or an intention to offer is indicated to the board of the target company, rests with the buyer, as opposed to the target. However, directors of the target company will be primarily responsible for making announcements after an approach has been received and should be aware of their continuing disclosure obligations under the SFO and the Listing Rules (see “General Disclosure Obligations” below), which will apply before and after an approach is received. Where there are negotiations between a potential buyer and the controlling shareholder in the situation as referred to above, the potential seller will be primarily responsible for making an announcement.
Usual Timetable

The Takeovers Code provides certain time limits within which announcements must be made, documentation must be despatched to shareholders, and the general offer must remain open for acceptance. Although the time required to complete a particular transaction will vary from case to case, it would normally be expected to take between three to four months to complete the takeover of a Hong Kong-listed company. The more important time requirements of the Takeovers Code are summarized below.

Time Limits Under the Takeovers Code

- Generally, the offer document must be despatched within 21 days of the first announcement (i.e., of an intention to offer or of the acquisition of a controlling stake) in the case of a cash offer, and 35 days in the case of a share exchange. The target company’s response document must, in turn, be forwarded within 14 days of the posting of the offer document. It is very common in Hong Kong where most takeover transactions are friendly rather than hostile, for the parties to prepare a composite offer document for which the buyer and the target accept joint responsibility.

- A general offer must remain open for at least 21 or 28 days from the date of the posting of the offer document (depending on when the target company’s response document is posted). If at any time, the terms of a general offer are revised (e.g., a higher price is offered), then the offer must be kept open for not less than 14 days from the date on which the revised offer document is posted.

- If a conditional offer is declared unconditional by the buyer (ordinarily by reason of satisfaction or waiver of conditions), the general offer must remain open for a further period of 14 days.

- Unless an offer has previously become unconditional, it may not be kept open after the expiry of 60 days from the date on which it is posted.

- A target company may not make announcements of any material new information (including trading results, profit or dividend forecasts, asset valuations or proposals for dividend payments or for any material acquisition or disposal or major transactions) after the 39th day following the posting of the initial offer document. Ordinarily, this will allow shareholders of the target company three weeks to assess the offer.

- No revised offer may be made after the expiry of 46 days from the original posting date (or, in more general terms, in the 14 days ending on the last day the offer is able to become unconditional).
It should be noted that in certain circumstances, the above time requirements may be waived or extended on a case-by-case basis by the Executive.

The Takeovers Code also contains detailed provisions regulating acquisitions of shares, in addition to the initial stake, before and during the general offer period.

**Acquisitions and Disposals by Public Companies**

Where either the seller or buyer is a Hong Kong-listed company (or a subsidiary of a listed company), certain issues will arise under the Listing Rules with respect to public disclosure and/or shareholders’ approval of the relevant transaction. Some of these disclosure and shareholders’ approval requirements applicable to Main Board-listed companies under the Main Board Listing Rules are summarized below. There are comparable provisions applicable to GEM-listed companies under the GEM Listing Rules.

It should be noted that the Listing Rules do not have the force of law. Rather, they are enforced by the Stock Exchange’s imposition of a wide range of sanctions upon listed companies and their directors, senior management, substantial shareholders and professional advisers. These sanctions range in severity and include private reprimand, public censure, referral to the SFC or other relevant regulatory body, exclusion from the market for a fixed period and, ultimately, suspension or cancellation of a company’s listing (the latter being very rarely applied).

However, under the SFO, the companies are required to file the disclosure materials, including announcements and circulars, with the SFC. Any person who intentionally or recklessly provides false or misleading information when making the disclosure would be subject to the statutory powers of the SFC of investigation and prosecution.

**General Disclosure Obligations**

**Under the SFO**

The SFO has been amended with effect from 1 January 2013 to establish a statutory disclosure regime ("Statutory Disclosure Regime") whereby listed companies are required to disclose certain price-sensitive information (defined as “inside information”) in a timely manner, backed by civil sanctions for non-disclosure of the inside information.
From 1 January 2013 under Part XIVA of the SFO, a listed company must, as soon as reasonably practicable after any inside information has come to its knowledge, disclose the information to the public, unless it can rely on one of the safe harbors.

The term “inside information” follows the definition of “relevant information” under the insider dealing regime and means specific information that:

• is about:
  - the listed company;
  - a shareholder or officer of the listed company; or
  - the listed securities of the listed company or their derivatives; and

• is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the company but would if generally known to them be likely to materially affect the price of the listed securities.

Civil sanctions include regulatory fines on the listed company and its directors and chief executive and disqualification and cold shoulder orders against its officers in default. The person in breach may also be liable to pay compensation to an investor who has suffered pecuniary loss as a result.

The SFC Guidelines on Disclosure of Inside Information (issued in June 2012) also take effect from 1 January 2013.

Under the Main Board Listing Rules

With effect from 1 January 2013, where a Main Board-listed company is required to disclose inside information under the Statutory Disclosure Regime, it must also simultaneously announce the information.

Furthermore, Main Board-listed companies have a general obligation to announce the information necessary to avoid a false market in its securities where, in the view of the Stock Exchange, there is or is likely to be such a false market. The Stock Exchange may also, in its discretion, request that an announcement be made following unusual movements in the price or trading volume of the securities.

The announcements will be posted on the Stock Exchange’s website and also on the Main Board-listed company’s own website. A trading halt or a trading suspension in the listed securities may be required in certain circumstances where an announcement cannot be made promptly.
Specific Disclosure Obligations

The specific disclosure and/or approval requirements for Hong Kong Main Board-listed companies (and their subsidiaries) are determined by reference to the nature of the relevant transaction. In general terms, the size and scope of the transaction will determine the extent of disclosure required. Transactions, known as “notifiable transactions”, fall into six categories:

- Share transaction
- Discloseable transaction
- Major transaction
- Very substantial disposal
- Very substantial acquisition
- Reverse takeover

There is also a separate category of transactions known as connected transactions. Whether a notifiable transaction falls into one category or another will mainly be determined by the nature of the transaction and the application of five separate tests (see the following section on “Transaction Classification Tests”). Once this is established, disclosure and approval requirements of that category will then apply. In the case of connected transactions (normally, related-party transactions), the important factor is the relationship of the parties rather than a straight application of the tests. A connected transaction may also fall under one of the other categories of notifiable transactions.

In certain circumstances, disclosure can be avoided where specific exemptions set out in the Main Board Listing Rules apply. Where specific exemptions do not apply, it may be possible to avoid the disclosure obligations by obtaining a waiver of the disclosure/ shareholders’ approval requirements from the Stock Exchange. Waivers are granted on a case-by-case basis.
Transaction Classification Tests

Share transactions, discloseable transactions, major transactions, very substantial disposals and very substantial acquisitions - To determine whether or not a particular transaction will be considered to be a share transaction, a discloseable transaction, a major transaction, a very substantial disposal or a very substantial acquisition, the tests set out below are applied. Transactions in these categories include acquisitions or disposals of assets (including shares) and include the entry into an option to acquire or dispose of assets as well as the transfer, exercise or termination of such an option.

Whether a transaction constitutes a share transaction, discloseable transaction, major transaction, very substantial disposal or very substantial acquisition is determined mainly by the nature of the transaction and by reference to the percentage ratios calculated by applying the following tests.

- **Assets test** - the total assets that are the subject of the transaction divided by the total assets of the listed company and its subsidiaries ("**Group**"). ("Total assets" is defined as total fixed assets, including intangible assets, plus total current and non-current assets, subject to the required adjustments.)

- **Profits test** - the net profits (after deducting all charges except taxation and before minority interests and extraordinary items) attributable to the assets which are the subject of the transaction divided by such net profits of the Group

- **Revenue test** - the revenue (normally, arising from the principal activities of a company and does not include those items of revenue and gains that arise incidentally) attributable to the assets which are the subject of the transaction divided by such revenue of the Group

- **Consideration test** - the fair value of the consideration divided by the total market capitalization (being the five-day average closing price of the listed company’s securities listed on the Stock Exchange) of the listed company

- **Equity capital test** - the nominal value of the listed company’s equity capital issued as consideration divided by the nominal value of the listed company’s issued equity capital immediately before the transaction

A transaction is then classified as follows:

- **Share transaction** is an acquisition of assets (excluding cash) by a Group where the consideration includes securities for which listing will be sought and where all percentage ratios are less than 5%.
• **Discloseable transaction** is a transaction (or series of transactions) by a Group where any percentage ratio is 5% or more but less than 25%.

• **Major transaction** is a transaction (or series of transactions) by a Group where any percentage ratio is 25% or more, but less than 100% for an acquisition or 75% for a disposal.

• **Very substantial disposal** is a disposal (or series of disposals) of assets by a Group where any percentage ratio is 75% or more.

• **Very substantial acquisition** is an acquisition (or series of acquisitions) of assets by a Group where any percentage ratio is 100% or more.

**Reverse takeovers** - A reverse takeover is an acquisition or a series of acquisitions of assets by a listed company (or its subsidiaries) that, in the opinion of the Stock Exchange, constitutes an attempt to achieve a listing of the assets to be acquired and a means to circumvent the qualification requirements for new listing applicants set out in Chapter 8 of the Main Board Listing Rules.

A reverse takeover normally refers to:

- an acquisition (or series of acquisitions) of assets constituting a very substantial acquisition where there is, or which will result in, a change in control (as defined in the Takeovers Code) of the listed company; or

- acquisition(s) of assets from a person (or group of persons) pursuant to an agreement, arrangement or understanding entered into by the listed company (or its subsidiaries) within 24 months of such person (or group of persons) gaining control (as defined in the Takeovers Code) of the listed company, where such gaining of control had not been regarded as a reverse takeover, which individually or together constitute(s) a very substantial acquisition.

**Connected transactions** - A connected transaction (or related-party transaction) is defined in broad terms to include:

- Any transaction between a listed company or any of its subsidiaries (“**Group Member**”) and a connected person.

- Any transaction between a Group Member and a non-connected person where:
  - the Group Member is acquiring or disposing of an interest (or 90% or more assets) in a company; and
  - a substantial shareholder of that company is (or will be) a controller (or its associate), where a controller means a director, chief executive or controlling shareholder of a Group Member.
• Any transaction between a Group Member and a non-connected person where:
  - the Group Member is acquiring an interest in a company (or an option);
  - a controller (or its associate) is (or will be) a shareholder of that company; and
  - the interest to be acquired is: of a fixed income nature; shares to be acquired on less favorable terms than the controller (or its associate); or a different class of shares from the controller (or its associate).

• Any transaction between a Group Member and a non-connected person where:
  - the controller (or its associate) is subscribing on specially favorable terms for shares in a company in which the Group Member is a shareholder; or
  - the controller (or its associate) is subscribing for shares in a company of a different class to those held by the Group Member.

• The provision of financial assistance in certain cases involving a connected person.

• The grant, transfer, exercise or non-exercise of an option involving a connected person.

• Entering into a joint venture with a connected person.

A connected person in relation to a listed company is normally a director, chief executive or substantial shareholder of a listed company (or any of its subsidiaries) or an associate of any of them.

A connected transaction may also be a notifiable transaction.

Generally speaking, the Main Board Listing Rules and the Stock Exchange require that most connected transactions are made conditional on the approval of the shareholders in a general meeting of the relevant listed company (at which any connected person and any shareholder (and its associate) with a material interest in the transaction is not permitted to vote) and that an appropriate announcement is published, an information circular is despatched to shareholders and certain details are disclosed in its annual report. However, these requirements will not be imposed where:

• The connected transaction is of the types exempted under Rules 14A.31, 14A.33 and 14A.65 of the Main Board Listing Rules, in which case the transaction will not normally require any disclosure or shareholders’ approval (unless it is a notifiable transaction to which such requirements apply).
These types of connected transactions normally include:

- the acquisition as consumer or realization in the ordinary and usual course of business of certain consumer goods or services by a Group Member from or to a connected person on normal commercial terms;

- a *de minimis* transaction on normal commercial terms where each of the percentage ratios (other than the profits ratio) is: less than 0.1%; less than 1% and the transaction is a connected transaction only because it involves a person who is a connected person by virtue of its relationship with the listed company’s subsidiaries; or less than 5% and the total consideration is less than HKD1 million;

- a transaction between a Group Member and a non-wholly-owned subsidiary or between its non-wholly-owned subsidiaries where no connected person at the listed company level controls 10% or more of the voting power of any of the subsidiaries concerned and none of the subsidiaries concerned is itself a connected person;

- a transaction between a listed company’s non-wholly owned subsidiary where any connected person at the listed company level controls 10% or more of the voting power of such subsidiary (“Connected Subsidiary”) and any of its subsidiaries which are connected persons only by virtue of being subsidiaries of the Connected Subsidiary; or a transaction between any of these subsidiaries;

- a transaction on normal commercial terms, which is a connected transaction only because it involves a person who is a connected person by virtue of its relationship with the listed company’s subsidiaries, and where the size of the relevant subsidiary is insignificant to the Group (by reference to their total assets, profits and revenue and the consideration test, as specified in the Main Board Listing Rules);

- a transaction of a revenue nature in the ordinary and usual course of the Group’s business and on normal commercial terms which is a connected transaction only because it involves an associate of a substantial shareholder who is a passive investor in the Group and meets the specified criteria in the Main Board Listing Rules;

- financial assistance from a connected person to the Group on normal commercial terms (or better) where no security over the assets of the Group is granted;
financial assistance from the Group (other than a banking company) on normal commercial terms (or better) to a connected person in which a Group Member is a shareholder, or to a company in which both a Group Member and a connected person are shareholders and where any connected person at the listed company level controls 10% or more of the voting power of such company ("relevant assisted company"), where the assistance is in proportion to the Group’s equity interest in the connected person or the company and any guarantee is given on a several basis; or

financial assistance from the Group (other than a banking company) on normal commercial terms (or better) to a connected person or a relevant assisted company where each of the percentage ratios (other than the profits ratio) is: less than 0.1%; less than 1% and the transaction is a connected transaction only because it involves a person who is a connected person by virtue of its relationship with the listed company’s subsidiaries; or less than 5% and the total value of the assistance plus any preferential benefit to the assisted person is less than HKD1 million.

Or:

- The connected transaction is of the types partially exempted under Rules 14A.32, 14A.34 and 14A.66 of the Main Board Listing Rules, in which case the Stock Exchange will normally only require disclosure in the form of publication of an announcement containing prescribed particulars and the inclusion in the listed company’s next published annual report and accounts of certain prescribed details relating to the transaction.

These types of connected transactions normally include:

- a transaction on normal commercial terms where each of the percentage ratios (other than the profits ratio) is: less than 5%; or less than 25% and the total consideration is less than HKD10 million; or

- financial assistance from the Group (other than a banking company) on normal commercial terms (or better) to a connected person, or a relevant assisted company where the assistance is not in proportion to the Group’s equity interest in the company or any guarantee is not given on a several basis, where each of the percentage ratios (other than the profits ratio) is: less than 5%; or less than 25% and the total value of the assistance plus any preferential benefit to the assisted person is less than HKD10 million.
Or:

- The Stock Exchange grants a waiver of compliance with the shareholders’ approval and/or disclosure requirements.

If an announcement is required, its terms will depend on the type of connected transaction but, generally speaking, in addition to the information required to be disclosed for a notifiable transaction (see below), a description of the connected relationship is required, together with the nature and extent of the connected person’s interest in the transaction.

If shareholders’ approval is required, the circular must also include the details of the Group, an independent valuation (if appropriate) and an opinion from an independent financial adviser and an independent board committee as to whether the transaction is fair and reasonable and in the interests of the listed company (and its subsidiaries) and its shareholders as a whole, and to advise shareholders on how to vote.

Special rules apply when the connected transaction is a “qualified property acquisition” through a government auction in certain situations.

**Disclosure and Approval Requirements**

As soon as possible, after the terms of a notifiable transaction have been finalized, the Main Board-listed company must:

- inform the Stock Exchange;

- prepare an announcement containing certain prescribed information, such as:
  - a description of the principal business activities of the Group and the counterparty (if applicable);
  - the date of the transaction and confirmation that the counterparty and its ultimate beneficial owner are third parties independent of the Group and its connected persons;
  - (except for share transactions) the general nature of the transaction including any restrictions on subsequent sale of any securities involved;
  - (for share transactions) details of the securities being issued including any restrictions on subsequent sale;
- brief details of the assets being acquired or disposed of, including the name of any company, business, assets or property where relevant and, if the assets include securities, the name and general description of the activities of the company in which the securities are or were held;

- the aggregate value of the consideration, how it is being or is to be satisfied, and the terms of any arrangements for payment on a deferred basis;

- the basis upon which the consideration was determined;

- the value of the assets which are the subject of the transaction;

- where applicable, the net profits (both before and after taxation and extraordinary items) attributable to the assets that are the subject of the transaction for the two financial years immediately preceding the transaction;

- the reasons for entering into the transaction, the benefits that are expected to accrue to the Group as a result of the transaction and a statement that the directors believe that the terms of the transaction are fair and reasonable and in the interests of the shareholders as a whole;

- (except for share transactions) in the case of a disposal, details of the gain or loss expected to accrue to the Group and the intended application of the sale proceeds;

- where appropriate, details of any guarantee and other security given or required in connection with the transaction;

- (for major transactions, very substantial disposals, very substantial acquisitions or reverse takeovers) the expected date of despatch of the circular, and if this is more than 15 business days after the publication of the announcement, the reasons why; and

- where the transaction is also a connected transaction, details of the relevant connections and a statement that the transaction is subject to independent shareholders’ approval, if applicable. Where independent shareholders’ approval is required, the expected date of despatch of the circular, and if this is more than 15 business days after the publication of the announcement, the reasons why;

- where the notifiable transaction constitutes a very substantial disposal, very substantial acquisition or reverse takeover or if so requested by the Stock Exchange, deliver a draft announcement to the Stock Exchange for review;
deliver copies of the announcement to the Stock Exchange (after it has been
reviewed by the Stock Exchange, if applicable). The announcement will be
posted on the Stock Exchange’s website and also on the Main Board-listed
company’s own website; and

finally, except for share transactions and discloseable transactions, despatch
to shareholders and the Stock Exchange a circular after it has been reviewed
by the Stock Exchange, containing the information prescribed in the Main
Board Listing Rules. The circular will also be posted on the Stock Exchange’s
and the company’s own websites.

Shareholders’ approval is not required for share transactions and discloseable
transactions.

In the case of a major transaction, very substantial disposal, very substantial
acquisition and reverse takeover (other than a “qualified property acquisition”
through a government auction which constitutes a major transaction or very
substantial acquisition, provided certain conditions are met), the transaction must
be conditional on the approval of shareholders of the listed company. Normally,
shareholders (and their associates) with a material interest in the transaction will
be excluded from voting at the general meeting. The circular (or listing document
for reverse takeovers) must normally include an accountants’ report on the
business or company being acquired (if applicable). In the case of a very substantial
disposal, an accountants’ report on the Group or financial information (reviewed by
the Group’s auditors or reporting accountants) of the disposal target is required.

A listed company must consult the Stock Exchange before entering into any
proposed transaction(s) which may require aggregation within the 24-month
period for the purposes of classification as a reverse takeover.

For a reverse takeover, the Stock Exchange will treat the listed company as if it
were a new listing applicant and the Group must satisfy the relevant new listing
qualifications and application requirements. It will be required, among other
things, to issue a new listing document.

Acquisitions of Minority Shareholdings

Where, following a general offer, a party has acquired not less than 90% of the
shares of a Hong Kong-incorporated company, it may invoke the procedures set
out in Section 168 and the Ninth Schedule to the Companies Ordinance in an
attempt to compulsorily acquire the shares of the minority shareholders.
Acquisitions of Fixed Assets from a Member of a Listed Group

Currently, on a sale of assets of a Hong Kong-incorporated company, that is listed on the Stock Exchange or a member of a group of companies that includes such a listed company, approval in general meeting of the shareholders is required, pursuant to Section 155A of the Companies Ordinance, if the amount or value of the consideration for the fixed assets to be sold exceeds 33% of the value of the company’s fixed assets. If there has been a disposal of any fixed assets of the company within the four-month period preceding the proposed sale, the amount or value of the consideration for such previous disposal will count towards the 33% threshold. This restriction will be removed when the new Hong Kong companies legislation becomes effective, tentatively in 2014.

If a company proceeds with a sale in breach of Section 155A, the court may, on an application from a member, restrain the transaction and the directors may be liable for a fine and even imprisonment. However, the failure to obtain the requisite approval will not invalidate a transaction entered into in breach of Section 155A.
Currently, there are very few restrictions on the ability of foreign investors to undertake M&A transactions in Hong Kong and transaction costs remain low by international standards. The legal and regulatory issues and local practice remain consistent with those applicable to similar transactions in other major international financial centers.
INDONESIA
DISCLAIMER

It should be noted that the material in this book is designed to provide general information only. It is not offered as advice on any particular matter, whether it be legal, procedural or other, and should not be taken as such. The laws and regulations summarized in this book are current as of 10 December 2012. The authors expressly disclaim all liability to any person in respect of the consequences of anything done or omitted to be done wholly or partly in reliance upon the whole or any part of the contents of this book. No reader should act or refrain from acting on the basis of any matter contained in it without seeking specific professional advice on the particular facts and circumstances at issue.

This may qualify as “Attorney Advertising” requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome.
Indonesia’s jurisprudence is based on the European civil law system. This difference from many other jurisdictions in the region, together with ongoing regulatory changes, requires careful consideration of the issues that arise in mergers and acquisitions ("M&A").

Indonesian law is constantly changing and many provisions in laws, in the absence of implementing regulations, are not always clear. In addition, it is likely that there will be amendments to existing laws or new laws in the near future.

Practice and Procedure

The practice, procedure and policy of relevant Indonesian government agencies, including the Ministry of Law and Human Rights, Bank Indonesia, the Capital Markets and Financial Institutions Supervisory Agency ("Bapepam-LK") and the Capital Investment Coordination Board ("BKPM") will be as important in consummating a transaction as the Indonesian laws governing M&A.

Company Law and M&A Regulations

The current Company Law was enacted in July 2007 and sets out a statutory framework for the combination of businesses conducted through limited liability companies. The Company Law emphasizes protection of minority shareholders in particular, as well as the interests of the company, its employees, the interests of society and fair competition.
Capital Markets Law

Where a merger or acquisition proposal involves a public company, the companies involved are also required to comply with the general requirements of the Capital Markets Law and the regulations of Bapepam-LK.

Bapepam-LK issues new regulations on a regular basis as the capital market sector continues to mature. These regulations can be accessed through Bapepam-LK’s website at www.bapepam.go.id but note that the website no longer contains up-to-date English-language translations.

Bapepam-LK will be subsumed by the Financial Services Authority in 2013. However, as with most agencies which will fall under the jurisdiction of the Financial Services Authority, Bapepam-LK’s regulations are expected to be adopted by the Financial Services Authority in the immediate term, until such time as it is fully operational.

Other Laws

For M&A in other sectors, companies are required to comply with specific laws and regulations (e.g., the banking sector, the insurance sector, the broadcasting sector and the telecommunications sector).
The following discussion will concentrate on M&A activity under the Company Law. There are five types of M&A transactions contemplated under the Company Law: mergers, consolidations, share acquisitions, spin-offs and asset acquisitions.

Mergers, Consolidations, Spin-offs and Acquisitions

The Company Law succinctly defines and differentiates between the concepts of merger, consolidation, spin-off and acquisition.

- A merger is a lawful act executed by one or more companies to merge with existing companies, which causes the dissolution of the merging companies but the continuing existence of the surviving company.

- A consolidation is a lawful act executed by two or more companies to fuse together, forming a new company, followed by the dissolution of both (or all) of the consolidating companies.

- A spin-off is a lawful act whereby either:
  - all of the assets and liabilities of a company are transferred by law to two or more companies and the transferring company is dissolved by law; or
  - a part of the assets and liabilities of a company are transferred by law to one or more companies and the transferring company still maintains its existence.
An acquisition is a lawful act executed by a legal entity in the form of a company or other entity, or by an individual, to takeover all or a majority of a company’s shares, whether existing or newly issued, which may cause a change in the control of the company. The Company Law does not state the meaning of “control” but it is reasonable to assume that the term refers to the capacity to determine, directly or indirectly, in any way, the management or policies of the company concerned.

Acquisitions that do not fulfill the criteria of size and control fall outside the acquisition requirements and procedures set out in the Company Law. Please note that where there is a change in control through the issue of new shares by a company this will be considered a change in control initiated by management.

A brief comparison of some of the major differences between mergers, consolidations and acquisitions, excluding spin-offs, is set out in Appendix A.

### Share/Asset Acquisitions

In considering whether to do an asset or share acquisition in Indonesia, the typical issues in other jurisdictions, including contingent liabilities, scope of business of the target company and so on, are relevant.

However, in conducting an asset purchase in Indonesia, acquirers should not underestimate the time that will be involved in concluding the transaction.

In particular, acquirers need to be aware of:

- the multitude of government agencies that may be involved in effecting the transfer of registrable assets;
- the procedures for acquiring good title to land; and
- the often time-consuming efforts needed to:
  - obtain consents and approvals (including those from banks, third parties and government agencies);
  - establish the new investment company as the purchaser;
  - obtain all general and industry-specific licenses for the business being acquired;
  - apply for expatriate work plans and permits; and
  - transfer over employees and deal with statutory benefits that may vest on the transfer.
While these matters are not insurmountable, they do make closing an asset acquisition much more difficult and time consuming. In many respects the business on an asset sale either needs to cease operating until all licenses are obtained or otherwise operates without licenses in its name (this is a consequence of licenses not being transferable in Indonesia).

In contrast, share acquisitions generally require far fewer consents and approvals and are less problematic.

**Privatizations**

Privatizations in the state sector may take the following forms in Indonesia:

- A spin off of assets into a new subsidiary of a state-owned company with a subsequent (concurrent) sale of shares in the subsidiary
- Where “state-owned” companies are already publicly listed, the sale by the government of its shares in an off-market transaction
- The establishment of a joint-venture company with a strategic partner and the spin-off or leasing of assets to the joint venture (either with a direct or delegated concession authority to conduct the business).

**Golden Shares**

In some of the Indonesian state-owned companies that have been privatized, the Republic of Indonesia owns one “golden share”, which is a share with certain veto powers on amendments to the articles of association, and on election of members of the board of directors and board of commissioners.

**Classes of Shares**

The Company Law allows a company to issue different types of shares, such as voting shares, non-voting shares, redeemable shares and shares with certain voting rights, among others, although approval of such different classes of shares is not necessarily always forthcoming from the Ministry of Law and Human Rights.

However, there are no provisions under the Company Law dealing with “redeemable preference shares” and their specific distinguishing characteristics as is found in common law company legislation. The key issue is that the ability to redeem shares must follow the share buyback procedures under the Company Law, which are restrictive (as discussed later in this guide) or occur by way of a capital reduction (the provisions of which under the Company Law specifically envisage a redemption of shares).
Foreign Investment Restrictions - Private Companies

Most private foreign investments (and domestic investments enjoying the same facilities) in Indonesia are administered and supervised by BKPM. Consequently, most matters relevant to M&A transactions must be reported to or be approved by BKPM.

A negative list of investments, which determines what business sectors are open for foreign investment, was published in May 2010 (and may, at the time of writing, be revised again). Additional material on the negative list is available on request.

In addition, the following material restrictions are applicable pursuant to other laws and regulations:

**Insurance** - maximum foreign ownership 80%, although a larger percentage can be held depending on the capital structure

**Securities** - maximum foreign ownership 99% depending on the capital structure

**Banking** - maximum foreign ownership 99% but subject to certain restrictions on the number of shares that any one shareholder may hold

**Finance companies** - maximum foreign ownership 85%

**Broadcasting companies** - maximum foreign ownership 20%
The following points should also be noted with respect to foreign investment:

- BKPM-issued regulations in 1994 require that 15 years after commercial production, an unspecified amount be divested to local companies or Indonesian citizens and, notwithstanding the enactment of the new Investment Law in April 2007, considers these regulations as current and enforceable and any prior approval requiring divestment to be complied with (even if the divestment is nominal in nature). New approvals now do not have divestment obligations.

- In certain industry sectors, e.g., retailing and plantations, although the investment regime has been liberalized, there are still conditions that require local companies or a cooperative, for example, to be engaged in the investment (e.g., as distributors, suppliers, equity partners); and

- BKPM issues policies on a frequent basis and these must be taken into account in structuring a deal.

**Foreign Investment Restrictions - Publicly Listed Companies**

Public companies are regulated by Bapepam-LK. If public companies are BKPM-approved investment companies, they will also fall under the jurisdiction of BKPM. Unless specifically provided under separate regulations, there are, in theory, no limitations on the percentage of shares held by foreigners in publicly listed companies as “indirect or portfolio investment” (namely there is no voting or management control (how extensive a shareholding can be depends on issues such as whether there is a larger Indonesian single shareholder, whether the foreign shareholder can control, etc., and detailed advice based on latest market practice and policy is required)). Please note that in certain sectors (e.g., retail, broadcasting) the regulations are contradictory, giving rise to some uncertainty and specific advice should be obtained.

**Competition Law**

The Anti-Monopoly Law has, to some extent, an extraterritorial reach over foreign entities that, although not domiciled or resident in Indonesia, are doing business within its borders. Foreign entities that are not doing business in Indonesia may also be affected by the Anti-Monopoly Law if they conclude agreements with Indonesian entities that may cause monopolistic or unfair business competition in Indonesia.
The Commission has the authority, among other things, to examine and approve mergers, acquisitions and consolidations that “have the potential to violate the Anti-Monopoly Law.” Unlike other jurisdictions the Anti-Monopoly Law only provides for post transaction notifications and one sanction being the cancellation of a transaction if the Competition Supervisory Commission (the “Commission”) believes that there will be monopolistic or unfair business competition if a transaction occurs. This is unique to Indonesia and makes assessing the impact of a transaction on the market critical before advancing too far.

The Commission has issued regulations:

- on merger/antitrust post transaction notifications (including the thresholds, requirements and process); and
- for prior non-binding consultations, which the Commission has stated it will abide by, provided there has been no material change in circumstances since the non-binding consultation occurred.

Asset sales and transactions between affiliates fall outside the merger control rules.

A market share standard is used as a parameter for: establishing a presumption of a monopoly, if a business player has more than a 50% market share; establishing a presumption of an oligopoly, if a group of business players has more than a 75% market share; or determining the existence of a dominant position, if a business player has more than a 50% market share and, as a group, those business players have more than a 75% market share. It should be noted that a dominant position is not unlawful as long as it is not abused.

The Anti-Monopoly Law also contains provisions regarding cross-shareholdings and common management criteria in determining anti-competitive conduct.

The Anti-Monopoly Law also regulates certain business practices, e.g., price fixing, price discrimination or boycotts of other business players. The Anti-Monopoly Law also prohibits certain agreements and activities if they “cause monopolistic practices and/or unfair competition,” which includes agreements with overseas parties, merging, acquiring and consolidating companies, or agreements to vertically integrate production.

The Anti-Monopoly Law exempts certain transactions from the law, even though these transactions may create a monopoly in an overseas market. These transactions must be “for export purposes and cannot disturb domestic supply and demand.”
The Anti-Monopoly Law also provides the necessary legal framework for the Commission.

**Exchange Controls**

Foreign exchange controls as such were abolished in 1971. Consequently, there are no restrictions or approval procedures on remittances of money or capital. But while the Investment Law guarantees the repatriation of dividends, capital and so forth, there are certain circumstances where the repatriation may be circumscribed.

In addition, Bank Indonesia has the authority to require information and data in respect of any flow of foreign exchange and has introduced regulations requiring the reporting of transactions over a certain value and limiting the remittance of foreign currency, unless there is an underlying transaction justifying the remittance of the foreign currency abroad.

Bank Indonesia is also authorized to determine (subject to stipulation by the government) the prevailing foreign exchange conversion mechanism.

All domestic transactions should be in Indonesian rupiah, unless those transactions are done in specific business sectors and for specific purposes and/or areas as stipulated by Bank Indonesia. Rupiah is not readily obtained offshore and usually transactions in rupiah either require the buyer to have expensive swaps or alternatively the transaction documents must have an exchange rate mechanism with payment being in foreign currency.

**Bankruptcy Law**

Acquirers will need to consider carefully the ramifications of the actio *pauliana* principle under the Bankruptcy Law.

**Actio Pauliana Principle**

The Bankruptcy Law provides that the Commercial Court, which deals with bankruptcy issues, may annul all legal acts of a bankrupt entity prejudicial to creditors that are not required by bona fide contracts or by law that were performed before the declaration of bankruptcy. The Commercial Court can only annul legal acts if it is proven (i.e., by the person challenging the act, such as the curator or prejudiced creditors) that at the time of performance of the challenged
act, the parties to that act knew or should have known that the act would prejudice the bankrupt entity’s creditor(s). There is no time limitation but clearly the further in the past that a transaction takes place, the less likely it is that it will be annulled.

Reversal of Onus of Proof

In certain circumstances, the onus of proof is effectively reversed. In these cases the parties to the act need to show they did not know or could not have known that the act would prejudice the creditors of the bankrupt entity. The reversal of the onus of proof occurs if, within the year prior to the declaration of bankruptcy, the bankrupt entity was not obligated to do any of the following:

- Enter into and perform a contract where the obligations of the bankrupt entity considerably exceed the obligations of the other parties.
- Pay or give security for a debt not due and payable.
- Enter into and perform an act with:
  - the management (i.e., members, and their extended families - to the third degree, of the board of directors and management);
  - shareholders (i.e., the direct or indirect majority shareholders, holding severally or jointly with members of their extended families to the third degree); or
  - individuals whose extended families (to the third degree) may be direct or indirect majority shareholders in the bankrupt entity.
- Enter into or perform an act with another legal entity having either:
  - a member of management in common with the bankrupt entity;
  - a person in management related (to the third degree) to a member of management of the bankrupt entity (or vice versa);
  - a member of management (or his extended family - to the third degree) of the bankrupt entity who owns (severally or jointly) a direct or indirect majority stake in the bankrupt entity (or vice versa); or
  - the legal entities, including the bankrupt entity, involved in the challenged act are, directly or indirectly, majority owned by the same persons (jointly or severally with members of their extended family - to the third degree).
- Enter into and perform acts between related group members.
The following points should also be noted:

- The broad reversal of the onus of proof is intended to capture the nature of Indonesian family conglomerates.

- The annulment of any act in contravention of the actio pauliana rule is not limited to acts that occur only within the year prior to the declaration of bankruptcy.

- There has been no real precedent in Indonesia as to how this concept (also in the Commercial Code) will operate. There is reportedly a Supreme Court ruling stating that actio pauliana can only be used in exceptional circumstances.

**Ramifications**

The ramifications of not properly assessing this risk is that any prior transaction (if buying a company) or the investor’s own transaction (if buying the assets or shares of a company) could be annulled, resulting in assets or shares bought being returned to the bankrupt entity and the investor (or the company in which the investor has bought shares) becomes an unsecured creditor of a bankrupt estate.

However, if a transaction is conducted on an arm’s length basis and in the ordinary course of business, the criteria should not be satisfied.
BKPM

Approvals/registrations are required from BKPM to any change in an approved investment plan, such as where an investment company is acquiring additional assets or purchasing shares in an established company or, as regards the target/selling company, where there is a change in status of the target/selling company, the investment plan of the target/selling company, or a change in the shareholders of the target/selling company.

As investment companies enjoy certain import facilities in the form of exemptions or deferment of duty, in asset acquisitions where the acquired assets are no longer entitled to such facilities, possible import duties obligations should be taken into consideration. BKPM approval is also required by sellers in asset disposals as invariably this affects the investment plan of the target company and the purchaser.

Ministry of Law and Human Rights Approvals, Notifications and Reporting

Entities wishing to amend their articles of association need to notify or obtain the approval of the Ministry of Law and Human Rights (depending on the amendments made). Similarly, the Ministry of Law and Human Rights will need to be notified of changes in the shareholding structure of any company.
Investors should note that all shareholder resolutions must be reduced into an Indonesian notarial deed within 30 days of the resolution and be filed with the Ministry of Law and Human Rights within a further period of 30 days (otherwise, the resolutions are deemed invalid under the Company Law).

**Ministry of Trade**

Many of the matters that require reports or notifications to be sent to the Ministry of Law and Human Rights or that need to be approved by the Ministry of Law and Human Rights, also need to be registered with the Ministry of Trade.

**Specific Industry Regulation**

Industry consents from the industry regulator may also be relevant, depending on the nature of the target’s business, e.g., banking, insurance, telecommunications, broadcasting, and mining and land matters. In some industries, a change of control or transfer of assets may simply require the notification to the relevant authorities rather than there being an obligation to obtain consent.

**Land Office**

The local Land Office needs to register land for there to be an effective transfer of land. There are certain titles (e.g., plantation land title) in a share acquisition where approval is still required from the local Land Office.

**Protection of Minority Shareholders’ Rights**

In the context of a merger, consolidation or acquisition, the company must take into consideration the interests of the company, the minority shareholders, employees of the company, the public interest and fair competition in carrying on business. Also, a consolidation, merger or acquisition must not prejudice the rights of minority shareholders to sell their shares at a reasonable price. This requirement is in part intended to prevent a majority shareholder from acting only for its own interest without considering the interests of the other shareholders.
Share Buyback

Rights of minority shareholders to have their shares bought bear resemblance to the share buyback provisions of the Company Law, which entitles minority shareholders to request that the company repurchase their shares in certain situations. In particular, this provision states that every shareholder will be entitled to sell its shares to the company at a reasonable price when that shareholder does not agree with the company’s actions or believes that they are detrimental to the shareholder or to the company. Although untested, this obligation may be satisfied by the issue of a debt instrument in exchange for the shares. The circumstances where this right can be exercised are: an amendment of the articles of association; the sale, the placing of security or the exchange of all or the majority of the assets of the company; or the consolidation, merger or takeover of the company. Although this right is expressed as a “request” to the company to buy its shares, the reality is that, if no legal impediment exists, the company must usually buy the shares in appropriate circumstances.

Requirements for Buyback

Shares need to be repurchased from net profits and in a manner so not as to reduce the net assets to become less than the aggregate of the subscribed capital and the statutory reserve.

The total nominal value of the shares held by the company or its subsidiaries (including those held under security) cannot exceed 10% of the nominal value of the subscribed capital (the calculation of the 10% also includes security held by the company itself over its shares and held by any other company directly or indirectly owned by the company).

Repurchased shares can only be held by the company as treasury shares for a period of three years. While the Company Law is silent, this means that after the three-year period the shares would need to be resold or otherwise a capital reduction would need to occur.

The delegation of authority to the board of commissioners in respect of conducting a share repurchase is limited to a period of one year.

Share repurchases conducted, directly or indirectly, contrary to the law are null and void and the directors are jointly and severally liable for losses. Curiously, the recipients of the proceeds from a share repurchase do not explicitly need to return the proceeds. However, this is an inherent result of the process being void.

A share repurchase is an amendment to the articles of association requiring a two-thirds quorum and approval in a general meeting of shareholders.
Shares held by a company in itself (whether through a share repurchase or otherwise) have no voting entitlements, cannot be used in establishing a quorum and cannot receive dividends.

**Minority Shareholders’ Right to Call for Examination**

The Company Law also imposes a rather draconian examination procedure whereby an examination of the company may be ordered by the chairman of a District Court upon submission of a written request, with reasons given, by: a minority shareholder(s) representing 10% of the issued shares; another person who is granted a right under a company’s articles of association or by contract with the company; or the public prosecutor representing the public interest. In reviewing such an application, the chairman of the District Court having jurisdiction over the company must find that there is reason to suspect that the company has committed an unlawful act that is detrimental to the shareholders or third parties, or that the directors or commissioners have committed unlawful acts that are detrimental to the company, the shareholders or third parties. An applicant for an examination must be able to demonstrate that he or she requested the information sought from the company and that the request was ignored or denied.

It is not clear whether a non-shareholder, such as an employee or his or her union, can request an examination because that person is within a class specially mentioned and protected by the Company Law, even though the right is not mentioned in the articles of association or in an agreement such as a collective bargaining agreement with the company.

While examiners are prohibited from disclosing the results of their examination to third parties, the results are made available to the District Court and the applicant and third parties may not be under any confidentiality obligations. Clearly, the examination process is not one that most companies would welcome.

**Minority Shareholders’ Suit**

A different procedure under the Company Law gives any shareholder of an Indonesian company the right to lodge a complaint against the company before a District Court, if the shareholder “is harmed by the actions of the company, which he considers unfair and with no reasonable grounds, as a result of a resolution of the general meeting of shareholders, the directors or the commissioners.” Not only is it unnecessary for the shareholder to own or represent 10% of the shares to start such an action, he or she does not even need to allege any unlawful act in connection with a request for an examination.
Non-regulatory consents and approvals that are required, generally, depend on any contractual arrangements of the company with third parties. In most cases, Indonesian banks require that the company borrowers obtain their prior approval for any merger, acquisition or consolidation (this is in addition to the non-objection rights of creditors required under the Company Law) and for changes in shareholder and/or management control.
Indonesia is generally considered a high tax jurisdiction and specific advice should be sought in relation to the structuring and planning of any transaction. In addition, Indonesia has introduced regulations which curtail treaty shopping and the use of double tax treaties.

**Jurisdictional Tax**

The current general rule is that gains on corporate reorganizations are taxable at a marginal rate of 25%. In fact, the Income Tax Law specifically states that transfers of assets in a liquidation process, merger or acquisition must, for tax purposes, be based upon their market value, unless otherwise allowed under a decision by the Minister of Finance. Also, notwithstanding the general rule that all the assets and liabilities of a company transfer “by operation of law,” companies with tax losses that merge into other companies do not automatically transfer the tax losses.

**Tax on Reorganizations**

The Regulation of Minister of Finance No. 43/PMK.03/2008 on 13 March 2008 (PMK 43/2008) sets out a new tax regime for reorganizations. PMK 43/2008 is supplemented by the issue of Regulation of Director-General of Taxes No. Per-28/PJ./2008 dated 19 June 2008 (Per-28/2008). The government has taken the firm position that book value mergers are still possible (thus not incurring tax on gain) but transfers of tax losses are no longer possible.
According to PMK 43/2008 and Per-28/2008, merging taxpayers can still use the book value, as long as they:

- submit an application to the Director-General of Taxation and explain the reason or objective of the business merger;
- settle all taxes payable for every related business entity; and
- pass the business purpose test.

The application must be submitted to the Regional Office of the Directorate-General of Taxes no later than six months after the date of the effective merger. The application must fulfill certain requirements including:

- using the standard application form provided by the Directorate-General of Taxes;
- attaching a statement letter that provides the reasons and purposes of the merger and business expansion and specified supporting evidence; and
- attaching a statement letter satisfying the business purpose test (advice should be sought on these requirements) in accordance with the standard format set out by the Directorate-General of Taxes.

The head of the Regional Office of the Directorate-General of Taxes will issue a decision letter within one month after the acceptance of a completed application. If after one month the head of the Regional Office has not issued a decision, the application will be considered approved.

Per-28/2008 also states, among other things, that:

- transfer of assets must be recorded at the book value; and
- all outstanding tax must be paid, including the taxes payable by branch offices or representatives of the companies.

PMK 43/2008 and Per-28/2008 also regulate procedures for acquisitions and spin-offs for companies (which are quite similar to the above procedures for mergers).

**Transactional Tax**

**Transfer Taxes**

**Sale of Shares**

Unlisted shares sold by resident taxpayers are subject to capital gains tax. Such gain will be treated as regular taxable income subject to normal income tax rates.
Generally, unlisted shares sold by non-resident taxpayers are subject to a 5% final withholding tax (20% of estimated net income of 25% of the sale price). Non-resident taxpayers may be protected from tax by the provisions of any applicable tax treaties.

Listed shares sold on the exchange by both non-resident and resident taxpayers are subject to a withholding tax of 0.1% of the transaction amount (and an additional 0.5% for founder shares of the share value at prescribed times if the tax for the founder shares has not been previously paid).

Transfer of Assets

Sellers are required to pay an income tax of 5% on the transfer of land and/or buildings, which is a final tax. Buyers are required to pay a 5% duty on the transfer of land and buildings.

Gains, based on the difference between the sale proceeds and book value, on assets sold by an entity are subject to tax at normal rates.

VAT of 10% is also chargeable on assets sold to an entity and is incurred by the purchaser.

If a company has obtained special duty-exemption facilities on certain imports (commonly known as a master list) then, unless the acquirer of the assets likewise has a master list, the transfer of assets within a certain period will result in the initial exemption from duty being revoked and the duty becoming payable, unless approval is obtained and the purchaser itself has a master list covering the assets to be purchased.

Likewise, in respect of other fiscal and tax incentives which may have been given to a company, these are not transferable in an asset transaction.

Stamp Duty

Stamp duty is nominal at IDR6,000 and is affixed by duty stamp at the time of signing.
Introduction

Employees of companies that are parties to mergers, consolidations or acquisitions are clearly one of the constituencies whose interests are to be considered and which, if affected (e.g., through a merger that results in layoff), can stop the transaction. It is not clear how employees could proceed directly and what provision of law gives them (or perhaps their union) standing. It is possible that employees must plead their case through the public prosecutor who, under the Company Law, can seek an examination (as discussed above) and who, as an ultimate weapon, may file a demand with the District Court to dissolve a company based upon well-founded reasons that the company has acted against the public interest. At the time of writing we have not seen any challenge on this basis in a transaction.

Mergers, Consolidations or Changes of Ownership

Article 163 (1) of the Labour Law provides that the change of a company’s status, a merger, a consolidation or a change of ownership of the company is deemed to be an event where the employees have the right to refuse or accept the new employment.

Under Article 163 (2), the employers (both the buyer and the seller) also have the right to terminate or maintain the employment in the event of the change of a company’s status, a merger and a consolidation (but not on a change of ownership).
The Labour Law does not specifically spell out the percentage of ownership that would trigger the entitlements but simply refers to a “change of ownership.”

However, the practice under the previous regulations that also carried this formulation of change of ownership (based on past practice and policies of the Ministry of Manpower) was that a change of less than 50%, which was not accompanied by any changes in human resources and management policies, was unlikely (but not guaranteed) to trigger the rights of employees. Unfortunately the Labour Law does not specifically refer to an indirect or direct change in ownership, and the Labour Courts have extended in some cases the provision to mean an indirect change in ownership as well as stating than less than a 50% change in shareholding can trigger employee rights.

Consequently, it is not sufficient just to consider the percentage shareholding being acquired; changes in management and employee policies to be adopted also need to be considered (e.g., rights and entitlements of the employees to be changed to the extent permitted by Indonesian laws and regulations, which are quite strict).

In summary while a “change of ownership” is frequently associated with the change of the controlling shareholder, this is not necessarily the case under the Labour Law. However, any substantial changes in management and employment policies will also trigger Article 163 (1), even if the new shareholder is not a controlling shareholder, if this will indirectly and directly affect employees.

In any event, cooperation of the employees is required to ensure a smooth transaction, so is a discussion with the target company’s human resources department on how employees may be dealt with. Typically in a transaction, employees will be asked to elect before closing whether they will exercise their rights to be terminated post closing so that the manpower position is known, or key employees must agree to continue working or a certain percentage of staff at certain levels within the target company must elect not to be terminated.

This issue is typically not a valuation issue (as there should be provisions in the target company for retirement benefits which are higher) but more of a cash flow and talent management issue.
Asset Acquisitions

In an asset acquisition, there is no automatic transfer of employment provisions under Indonesian law, and employees need to be terminated (or negotiated resignation letters obtained) by the selling company and the employees rehired by the acquiring company. Normally, where employees consent, employees’ accrued entitlements can be taken over by the acquiring company without the need to resort to the Labour Court.

The employees’ cooperation is required in ensuring a smooth transaction.

Termination Payments

Termination payments consist of the following, depending on the terms of employment (including benefits) and the period of employment:

- A severance payment (the basic payment due to the termination);
- A long-service payment (recognizing the employee’s service); and
- Compensation (e.g., for untaken annual leave, housing allowances, if provided for in the company’s regulations).

Labour Courts

If the transaction (e.g., merger but no acquisition) results in an employer having the right to terminate employees, approval from the Labour Court will be required.

As parties to a transaction rarely wish to go to the Labour Court, alternative commercial schemes are usually implemented to avoid proceedings.

Industrial Relations Plan

Even in a share acquisition, an industrial relations plan must be drawn up and discussions held with unions to ensure that the employees will accept the continuing accrual of entitlements rather than having the entitlements paid out. In certain situations some employees are taking advantage of the regulations and are seeking the payment of entitlements and then asking for a “re-commencement of employment.”
Investors should not underestimate the importance of considering employee issues early in their negotiations and allocating the responsibility of payment (whether in provisioning in completion accounts or otherwise) between the parties.

In addition, not only may there be cash-flow issues for the target company if employees chose to resign (on a merger or share acquisition), but there may also be employee relations issues in ensuring that there is a workforce to continue running the business.

**Specific Advice Required**

We strongly recommend that specific advice be obtained prior to entering into negotiations for a transaction given ongoing developments under the Labour Law.
Documentation

Consolidations and Mergers

In a proposed merger or consolidation, the board of directors of all of the companies intending to consolidate or merge must prepare a proposal of merger or consolidation ("Proposal") that must be approved by the respective boards of commissioners. Once approved, the directors of the respective companies intending to merge or consolidate must prepare the plan for the consolidation or merger ("Plan") that should be based on the Proposals. At a minimum, the Proposals and Plan must include, among other things:

- the names of the companies intending to consolidate or merge;
- the reasons for, and an explanation of, the proposed consolidation or merger by the respective directors of the companies intending to consolidate or merge, and the actual terms of the merger or consolidation; the reasons and explanation should comprise the business reasons that justify the transaction from the perspective of shareholder value;
- the mechanical procedures for the conversion of the shares of the respective companies into shares of the surviving company resulting from the merger or consolidation; this requirement applies where the essential economic transaction between the respective companies must be described;
• any amendment of the articles of association of the surviving company in the case of merger, or a draft of the deed of establishment of the new company resulting from a consolidation; in most cases, a merger will require amendments to the surviving company’s articles of association, for instance, to increase its authorized share capital; this is the case because the Ministry of Law and Human Rights maintains a policy, stemming from the interpretation of Article 26 of the Company Law, that the authorized capital of a company cannot be greater than four times its paid-up capital. A new deed of establishment will clearly be required in every consolidation and such a deed will necessarily require the approval of the Ministry of Law and Human Rights;

• balance sheets and profit and loss statements for the latest three years from all the companies intending to consolidate or merge; it is implicit in this requirement that companies that have not been established long enough to be able to produce such financial results cannot consolidate or merge (although this view may be changing);

• pro forma balance sheets and profit and loss statements of the company post-merger or post-consolidation prepared by an independent adviser;

• details settling the employees’ status;

• arrangements for any dissenting shareholders and creditors; and

• management analysis on the financial and operational issues relating to all relevant companies.

A merger or consolidation may only be completed if the Plan, containing the prescribed elements together with the draft deed of merger or draft deed of consolidation, is approved by a general meeting of shareholders of each of the companies involved. A three-quarters vote is required at a general meeting of shareholders where a quorum of three-quarters of the shares with valid voting rights is present. Before the transaction is submitted for approval to the general meeting of shareholders, the directors must publish a summary of the Plan in one national newspaper and make an announcement in writing to the employees at least 30 days prior to “calling” the general meeting of shareholders. Creditors have the right to object to the conclusion of a consolidation or merger within 14 days after the newspaper announcement (such objections need to be settled prior to or at the general meeting of shareholders in order for the merger or consolidation to proceed).
The purpose of the publication requirement is to give the parties concerned an opportunity to be informed so that if they believe their interests may be harmed, they may take certain steps to defend those interests. This refers to a separate requirement in the Company Law, discussed below, that a merger, acquisition, spin-off or consolidation plan must take into account the interests of the company, minority shareholders, employees and other affected parties. In particular, the rights of minority shareholders and employees would need to be guaranteed by the implementation of a merger, consolidation or acquisition plan. In addition, the implementation of the Plan would also need to guarantee public interest and maintenance of healthy business competition, introducing antitrust concepts into the procedures.

The deed of merger or deed of consolidation, as approved by shareholders, needs to be executed in notarial form.

Share Acquisitions under the Company Law (Vertical Mergers)

In general, the procedures for acquiring the shares of another company are very similar to the requirements for a merger or consolidation where the acquisition is instigated by the management of the relevant companies. The directors of each of the companies involved must prepare a proposal ("Acquisition Proposal") that needs to be approved by the respective boards of commissioners. The Acquisition Proposals need to be reduced to a plan that is then adopted by the directors of the companies involved ("Acquisition Plan") and laid before a general meeting of shareholders of each company.

The Acquisition Plan must include, among other things:

- the names of the companies;
- the reasons for, and an explanation of, the terms and procedures for the acquisition of the shares to be acquired;
- the latest financial statements of the acquiring company; and
- the pro forma consolidated balance sheet and profit and loss statement post-acquisition prepared by independent advisers.

Similarly, the general meeting of shareholders of both companies that are party to an acquisition must approve the Acquisition Plan by a three-quarters vote (where a quorum is present of three-quarters of the shares with voting rights).

In addition, the Acquisition Plan must be published and notifications provided in the same manner as for a merger or consolidation.
The deed of acquisition, as approved by shareholders, needs to be executed in notarial form.

**Share Acquisitions in General**

Under the Company Law, where there is a change in control of a company, notifications to creditors and employees must occur at least 30 days prior to calling the general meeting of shareholders to approve the transaction.

The documentation, whether all or some of the shares of the target company are purchased, will normally include a share purchase agreement and a simple deed of transfer for the shares. The latter is required by the Company Law.

The transfer of shares will not be recognized or valid as far as the target company and third parties are concerned unless the transfer is recorded in the share register of the target company (and registered at the Ministry of Trade).

If the share acquisition is only partial, the legal documentation will also normally include a joint-venture agreement or a shareholders’ agreement. The usual concerns, about suing joint-venture partners where the acquisition is partial, come to the fore.

If the buyer will provide technical assistance or other services to the target company, a technical services agreement or similar agreements may also be executed.

**Asset Acquisitions**

Legal documentation for an asset acquisition tends to be more complicated than documentation for a share acquisition since the former involves the transfer of different categories of property. Different categories of property will often require different transfer documentation.

In an asset acquisition there is typically an asset purchase agreement assigning the assets purchased in broad terms. However, there are also various deeds of assignments for specific property such as shares, intellectual property, real property and motor vehicles. Key personnel of the target company may also execute employment agreements, if the assets or business is bought as a going concern.

In an acquisition of assets transaction that involves the transfer of the entire or a substantial part of the assets of the target company, the directors of the company must obtain approval at a general meeting of shareholders under Article 102 of the Company Law.
A 75% vote of shareholders, with a quorum of the shares with valid voting rights, and public publication are required.

If the company acquiring the assets is acquiring them for cash, debt, shares or other types of consideration, the type and character of the company, as well as the amount involved, and the acquiring company’s articles of association, will determine what corporate approvals are required. These procedures do not contain the same level of concern for the protection of non-shareholders as do the procedures for mergers, consolidations, spin-offs and share acquisitions, despite the fact that there could still be significant effects on employees, competition and, presumably, other public interests. Nevertheless, a standard of proper due diligence inquiry and disclosure of material information could be expected of the directors of the companies involved in order to fulfill their duties to the company and avoid personal liability for failing to properly discharge such duties.

**Independent Advisers**

It is advisable in mergers, consolidations, spin-offs and acquisitions that independent advisers such as auditors, lawyers, asset appraisers and financial advisers are utilized to obtain independent opinions as to the fairness of the values and transactions. By taking into consideration the advice of such independent advisers, the directors can be said to have acted in the best interests of the company.

In several respects, including tax, it is advisable for private companies not otherwise bound by Bapepam-LK disclosures and due diligence requirements to nevertheless adopt these requirements.

**Due Diligence**

Pre-acquisition reviews can be a challenge for the following reasons:

- Many Indonesian companies do not maintain adequate records from a legal perspective, or indeed books of account from a financial perspective. Often, information sought in a pre-acquisition review cannot be found readily or simply does not exist. For example, many companies do not maintain share registers, notwithstanding that it is a requirement of the law.

- Unless a special relationship has developed between seller and buyer, Indonesian sellers are very concerned about confidentiality in a society not used to observing it.
• Access to public information is limited. Litigation and land searches require the target company to provide a power of attorney authorizing the inspection of its public records. Only with litigation searches will there be a written report from the governmental agency concerned. With land searches, generally only an oral “okay” is received from the relevant regional Department of Lands.

Commonly, the pre-acquisition review process in Indonesia is also an education exercise, especially where the seller is inadequately advised, with the buyer and its advisers cajoling the information from the seller.

Representations and Warranties

Many Indonesian companies are not keen to give comprehensive representations and warranties and require purchasers to do comprehensive due diligence on the target company or business prior to closing.

To the extent that representations and warranties are given, Indonesian sellers will be concerned to ensure that there is a short period in which claims can be made, that there are adequate materiality standards and that there are thresholds before claims can be made.

While it is common in other jurisdictions to have a disclosure letter or schedule to further mitigate a seller’s risk under the representations and warranties, frequently in Indonesia disclosure letters or schedules are not prepared (although this will depend on the transaction, the advisors and the concerns of the seller).

Buyers need to be aware that enforcement of claims for breach of warranties may be difficult in an Indonesian transaction and consequently, while this would be resisted by the seller, buyers should consider withholding part of the purchase price until an audit has been undertaken post closing (or for a limited time if the buyer has conducted a thorough review at the pre-acquisition stage).
Completion

Effectiveness of Consolidation, Spin-offs, Merger or Acquisition

A consolidation (and the dissolution of consolidating companies) becomes effective upon the date that the deed of establishment of the new fused company is approved by the Ministry of Law and Human Rights. In any event, the submission of the deed of consolidation to the Ministry of Law and Human Rights must be made within 14 days after the general meeting of shareholders.

The time when a merger becomes effective depends on whether amendments are required to the articles of association of the company resulting from the merger. Where such amendments require approval by the Ministry of Law and Human Rights (which, as noted above, will usually be the case) the merger becomes effective on the date the Minister of Law and Human Rights issues his approval to the amendments. If the merger does not require approval for the amendments to the articles of association, then the merger and the amendments must only be reported to the Minister of Law and Human Rights and the merger becomes effective on that date. If the merger does not require any amendments to the articles of association, then the merger becomes effective on the execution of (or at a later date as agreed under) the deed of merger.

The merging company is also considered dissolved on the date that the merger becomes effective. The dissolution can be effected with or without prior liquidation of the consolidating or merging company.

As in the case of mergers, share acquisitions following the Company Law become effective on the approval of the Minister of Law and Human Rights or on the execution of (or at a later date as agreed under) the deed of acquisition, as the case may be.

Share and Asset Acquisitions

For share and asset acquisitions much will depend on the terms of the acquisition documentation. The position in Indonesian legal documentation is not dissimilar from other jurisdictions in the Asia-Pacific region.

There are several specific Indonesian issues that need to be addressed:

- If a substantial part or all of a company’s business is to be transferred, Article 102 of the Company Law requires that the shareholders of the transferring company approve the disposal.
• All share transfers must be in the form of a deed and may be reduced to an Indonesian notarial deed if not executed in that form.

• Preemptive rights on the transfer of shares between shareholders are commonplace and, unless specifically excluded in the articles of association, are provided for in the Company Law.

• Notaries are generally involved in closing as they normally deal with reporting requirements to various government agencies and, where necessary, prepare relevant documentation in notarial form.

• Directors and commissioners of the company need to be appointed by the general meeting of shareholders and not by the outgoing boards.

Please note that for an acquisition by way of a subscription of shares, the subscriber will not be able to exercise its rights until the shares are authorized as issued by the Ministry of Law and Human Rights and the subscriber’s name is entered into the shareholders’ register of the target company.
Applicable Laws

Where one or more public companies are involved in a merger, consolidation, spin-off or acquisition, then in addition to complying with the Company Law, the Investment Law and other relevant laws, the more extensive corporate and disclosure requirements of the Capital Markets Law must be followed. The regulations issued by Bapepam-LK, the equivalent of the US Securities and Exchange Commission, and the Indonesia Stock Exchange ("IDX") to regulate the merger, consolidation, spin-off or acquisition of public companies also need to be followed. The regulations generally set out requirements similar to those for private companies whereby all transactions must be fair and transparent.

There will be circumstances where the Capital Markets Law is not entirely clear and thus further case-by-case clarification or confirmation with Bapepam-LK would be required.

Apart from the normal takeover route, there are other avenues through which investors can acquire a shareholding, including:

- acquisition of a shareholding through a debt-to-equity swap;
- acquisition of a shareholding through a private placement; or
- acquisition of a shareholding through a rights issue.

Although these concepts are discussed below, it is essential to seek advice on the practice and procedure for specific transactions at the relevant time.
Acquisition of a Substantial Shareholding Resulting in a Tender Offer Being Made

Takeover Threshold

Under Decree of the Chairman of Bapepam-LK No. KEP-264/BL/2011 dated 31 May 2011 on Takeovers of Public Companies (“Regulation IX.H.1”), a takeover of a public company is defined as an action, directly or indirectly, causing changes to the controller(s) of the company. The controller of a public company is defined as a party(ies) that:

- owns shares of more than 50% of the total issued and paid up share capital; or
- has the ability to, directly or indirectly, determine, in whatever manner, the management and/or the policies of the public company.

An increase in an investor’s shareholding, where the investor is already considered to be in control of a public company, does not constitute a change in control requiring a tender offer to be made.

Disclosure of Negotiations

An acquirer that is undertaking negotiations may provide information regarding the negotiations to the target company, Bapepam-LK, the IDX, and the public.

If the notification and announcement are carried out, any material development in the negotiation must be reported periodically to the target company, Bapepam-LK and the IDX no later than two working days after the development in the negotiation occurs.

The notification and announcement of the negotiation should contain prescribed information including:

- the name of the target company and the number of shares to be acquired;
- the name and details of the acquirer (i.e., the acquirer’s name, address, telephone/fax number, business activity and the purpose for taking control);
- the methods adopted during the process of negotiations on the takeover; and
- the substance of the negotiations on the takeover.
Disclosure of Takeover

In a takeover, the new controller must announce to the public and submit to Bapepam-LK within one working day after the takeover occurs:

- the number of acquired shares and the new controller’s total ownership; and
- the name of the acquirer, address, telephone/fax number, business activities and the purpose for taking control.

Takeover to be Followed by Mandatory Tender Offer ("MTO")

Unless the takeover falls under an exemption, a takeover must be followed by a mandatory tender offer for all the remaining shares, except for:

- shares owned by the selling shareholder(s);
- shares owned by another party that the acquirer has offered to purchase under the same terms and conditions;
- shares owned by other parties that are also undertaking a [different] tender offer on the shares of the target company [a competing tender offer];
- shares owned by principal shareholder[s]; and
- shares owned by other controlling shareholders of the target company.

No MTO is required where control is acquired pursuant to the following situations:

- Marriage or inheritance
- A purchase of or acquisition of shares of a public company during any 12-month period in an amount up to 10% of the total shares;
- An execution of the duties and authorities of governmental or state entities under prevailing regulations
- A direct purchase of shares owned by a governmental or state entity in relation to the execution of their duties and authorities
- An acquisition pursuant to a final and binding court order or judgment
- A merger or liquidation of the shareholder in the public company
- A grant of the listed shares (which is a delivery of shares without an agreement to receive any payment whatsoever in return)

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1 Principal shareholder is defined in the Capital Markets Law as a party that owns, directly or indirectly, at least 20% of all voting rights issued by a company.
• An enforcement of a security right for certain obligations (whether governed under a loan agreement or in the framework of debt restructuring)

• A purchase or subscription for shares or other types of securities pursuant to shares issued under the Rights Issue Regulation ("Regulation IX.D.1") and Exemption to Rights Issue Regulation ("Regulation IX.D.4");

• An acquisition of shares as an implementation of government policy

• An execution of an MTO that will be contradictory to laws and regulations

• An acquisition of shares as the result of a tender offer based on Regulation IX.F.1 on Voluntary Tender Offers

**Requirement to Divest**

Under Regulation IX.H.1, if, as the result of the MTO made after the takeover, the new controller owns more than 80% of the total paid-up capital of the target company, the new controller must, within two years after the completion of the MTO, undertake a corporate action to reduce the new controller to a level that is less than 80%; such that the public will own at least 20% of the total paid-up capital of the target company (and that 20% must be owned by at least 300 parties).

Regulation IX.H.1 also stipulates that if, as a result of the takeover, the new controller owns more than 80% of the total paid-up capital of the target company and is required to undertake an MTO, the new controller must, within two years after the completion of the MTO, undertake a corporate action to reduce the new controller to a level before the MTO is undertaken (and the amount in public hands must be owned by at least 300 parties).

The distinction between these two scenarios is that in the first, the new controller does not obtain more than 80% in the initial takeover. In the latter scenario, the new controller does obtain more than 80% in the initial takeover.

**Exemption to Divest**

The new controller’s obligation to divest shares does not apply if the public company, after the takeover and prior to the divestment period, conducts a corporate action that results in the divestment requirement being satisfied.
Tender Offer Pricing on a Takeover

Under Regulation IX.H.1, the pricing for a mandatory tender offer being made as a result of a takeover is different from the pricing for a voluntary tender offer under Regulation IX.F.1. The following pricing needs to be followed:

- Direct takeover of a public company whose shares are not listed and are not traded on the stock exchange - the tender offer price will be at least equal to either the takeover price or the fair price determined by an independent appraiser, whichever is higher.

- Direct takeover of a public company whose shares are listed and traded on the stock exchange but such shares have not been traded or have been suspended for 90 days or more prior to the announcement of the commencement of negotiations or the takeover announcement - the tender offer price will be at least equal to the average of the highest daily traded price reached during the 12-month period prior to the last trading or suspension or the takeover price, whichever is higher.

- Direct takeover of a public company whose shares are listed and traded on the stock exchange - the tender offer price will be at least equal to the average of the highest daily traded price reached during the 90-day period prior to the announcement of the commencement of negotiations or the takeover announcement, or the takeover price, whichever is higher.

- Indirect takeover of a public company whose shares are not listed and are not traded on the stock exchange - the tender offer price will be at least equal to a fair price determined by an independent appraiser.

- Indirect takeover of a public company whose shares are listed and traded on the stock exchange but which have not been traded or have been suspended for 90 days or more prior to the announcement of the commencement of negotiations or the takeover announcement - the tender offer price will be at least equal to the highest price reached during the 12-month period prior to the last trading or suspension.

- Indirect takeover of a public company whose shares are listed and traded on the stock exchange - the tender offer price will be at least equal to the average of the highest daily traded price reached during the 90-day period prior to the announcement of the commencement of negotiations or the takeover announcement.
Mandatory Tender Offer Process

The mandatory tender offer process must start within two working days after the takeover and must be implemented in accordance with Regulation IX.H.1.

The process of the tender offer starts with the submission of the draft tender offer announcement to Bapepam-LK and the target company. At the latest two working days after Bapepam-LK allows the publication of the tender offer announcement, the new controller must announce the tender offer announcement in one Indonesian daily newspaper having nationwide circulation. The tender offer should start one day after the announcement and should last for 30 days. The tender offer must be settled, by making cash payment, at the latest 12 days after the end of the tender offer period. The new controller must report the result of the tender offer to Bapepam-LK at the latest five working days after the completion of the tender offer.

If an announcement of the commencement of negotiations is made, the mandatory tender offer must be implemented within 180 days after that announcement.

Voluntary Tender Offers

Voluntary Tender Offer Procedure

A tender offer could be made without acquiring an initial controlling stake in a public company, i.e., where the proposed investor does not have control of the public company, as discussed above (although it may own shares below the 50% threshold).

A tender offer is an offer made through the mass media to acquire equity securities through the purchase or exchange of other securities (see the box: Ten Step Procedure for a Tender Offer).

Equity securities are shares or securities that can be exchanged for shares or securities having rights to obtain shares, such as convertible bonds.

The mass media includes newspapers, magazines, films, television, radio and other electronic broadcast media, or letters, brochures and other printed articles distributed to more than 100 parties.
Ten-Step Procedure for a Tender Offer

A tender offer must follow certain procedures that can generally be divided into 10 steps, namely:

1. The party that intends to make a tender offer (“Party”) must submit a Tender Offer Statement to Bapepam-LK, IDX, the target company, and other parties conducting a competing tender offer (if any). The Tender Offer Statement must contain, among others, the following information:
   - The identity of the target company
   - Information regarding the shares subject to the tender offer (including the tender offer price and tender offer period)
   - The identity of the Party making the tender offer
   - The requirements and special conditions of the tender offer
   - The number of equity securities of the target company that the Party already owns (a target company is a public company or issuer whose Equity Securities are listed on the stock exchange and whose securities become the object of a tender offer)
   - A statement by an independent accountant, bank or underwriter, that the Party has adequate funds to finance the tender offer

2. All information in the Tender Offer Statement must be announced in at least two Indonesian daily newspapers, one of which must have nationwide circulation, on the same date the Tender Offer Statement is submitted to Bapepam-LK.

3. The tender offer will become effective on the 15th day after Bapepam-LK receives the Tender Offer Statement properly completed, or earlier if declared effective by Bapepam-LK. In the case of an amendment or supplement to the Tender Offer Statement, the 15th day will be 15 days from the date Bapepam-LK receives the properly completed amendment or supplement.

4. Any amendment to the Tender Offer Statement must be announced not later than one working day after the Tender Offer statement becomes effective.

5. During the tender offer period, the Party may make a repeat announcement of the Tender Offer Statement.
Ten-Step Procedure for a Tender Offer

6. The tender offer period will start at the latest two working days after the Tender Offer Statement is declared effective and must last for at least 30 days. The tender offer period can be extended up to a maximum of 90 days, unless otherwise approved by the chairman of Bapepam-LK.

7. Transactions arising from the tender offer must be settled no later than 12 days after the offer expires, by either transferring money and securities as a means of exchange or by returning securities that may have been tendered where any special conditions stipulated in the tender offer are not fulfilled or if the tender offer is cancelled. If the tender offer is made through the exchange of the target company’s securities for other securities, the Party may choose whether to accept the other securities or money.

8. If the number of securities offered for sale exceeds the number of the securities determined in the tender offer, the Party must make allotments in proportion to the participation of each party/offer in the tender offer, by taking into account trading lots prevailing on the IDX.

9. The Party must appoint an auditor registered with Bapepam-LK to carry out a special audit of fair allotment and submit its report to Bapepam-LK within a period of 30 working days after the date of allotment expires. This procedure does not apply to a tender offer pursuant to a takeover.

10. Within a period of 10 working days after the date the Tender Offer is completed or cancelled, the Party must report the completion or cancellation of the Tender Offer to Bapepam-LK.

Tender Offer Price

Unless determined otherwise by Bapepam-LK, the tender offer price for shares listed and traded on the IDX must be higher than:

- the highest tender offer price previously offered by the same party within a period of 180 days before the announcement of the Tender Offer Statement is made; and

- the highest market price of the securities on the IDX during the 90-day period before the announcement of the Tender Offer Statement is made.
General Issues Relating to Tender Offers

Chain Principle

Indonesia adopts the chain principle in determining whether a party might have control over a public company in Indonesia. Consequently, an offshore acquisition or buying into a position of control, whether directly or indirectly, or acting in concert with others who may have control, could result in an investor being required to make a tender offer for the Indonesian public company.

Transactions Outside the Stock Exchange

The purchase of shares (and other securities transactions) can also be made outside of the IDX between a willing seller and willing buyer. As a general rule, transactions within the framework of a tender offer can directly be made between the buyer and the seller outside the IDX.

Conditional Offers

If a takeover is done (regarding a private sale to acquire shares) prior to a tender offer, the general rule is that a tender offer must be for all of the public shares of the listed company (subject to specific exemptions listed above) unless Bapepam-LK approves otherwise.

If no prior takeover occurs, but rather a straight tender offer is made for all shares, it is possible to specify a limit on the number of shares to be acquired on a proportional basis from all shareholders.

Incorrect or Misleading Information in the Tender Offer Statement

A target company, a party affiliated\(^2\) to the target company or a party that makes a tender offer for the same shares at the same time, may make a written statement

\(^{2}\) An affiliate is defined as a:

- family relationship by reason of marriage and descent up to the second degree, both in direct as well as collateral line;
- relationship between a party and its employees, directors, or commissioners;
- relationship between two companies, where one or more members of the board of directors or board of commissioners is/are the same person(s);
- relationship between a company and a party, which either directly or indirectly controls or is controlled by that company;
- relationship between two companies controlled either directly or indirectly by the same party; or
- relationship between the company and the principal shareholders.

(Art. 1. Capital Market Law)
to support or oppose the tender offer. The statement must be announced in at least two Indonesian daily newspapers (one of which must have nationwide circulation), no later than 10 business days before the tender offer expires.

If the board of directors or the board of commissioners of the target company knows, or has adequate reason to believe, that the information contained in the Tender Offer Statement is incorrect or misleading, the target company must make a statement, announced in at least two Indonesian daily newspapers (one of which must have nationwide circulation), no later than 10 business days before the tender offer expires.

Extension of the Tender Offer Period and Change in the Requirements for the Tender Offer

Any extension of the tender offer period must be announced two days before the extension period starts. The announcement must be published in two Indonesian daily newspapers, one of which has nationwide circulation, and must contain the number of offers already received up to the start of the extension period.

Any change in the requirements for the tender offer may only be made 15 days or more before the tender offer ends. The change must be announced in two Indonesian daily newspapers, one of which must have nationwide circulation, and must be submitted to Bapepam-LK and the parties concerned at the same time the announcement is made.

Acceptance of Tender Offer

Any person intending to accept the tender offer and to sell its shares must forward its shares to an appointed custodian. A person may withdraw acceptance at any time before the tender offer ends. Tender offer acceptance forms may only be distributed after the Tender Offer Statement becomes effective. The form must contain a statement that the party accepting the offer has already received and read the Tender Offer Statement.

Duty to Purchase Securities by Offering Party

If the tender offer results in the target company failing to meet the requirements for listed securities on the IDX, the offering party must buy all shares offered by all parties, with the exception of shares owned by the substantial shareholders. A substantial shareholder is a party (in practice, this includes its affiliates) who directly or indirectly owns at least 20% of the voting shares of the target company.
Prohibitions and Restrictions Applicable to Tender Offers

Several prohibitions and restrictions apply in relation to tender offers. First, the offering party is banned from purchasing or selling equity securities under the process of the tender offer, during a period of 15 days before the date of the announcement of the Tender Offer Statement until the expiry date of the tender offer. Also, the target company is prohibited from carrying out transactions with the aim of obstructing a change in the control of the target company during the period starting from the date of the announcement of the Tender Offer Statement until the expiry date of the tender offer. The offering party is also prohibited from imposing different restrictions and requirements for different shareholders in the target company, unless there already exists a distinction in the class rights of shareholders in the target company.

Creep Rule

A 10% annual creep acquisition is permitted and a tender offer is not required if an investor has acquired shares of 10% on an annual basis notwithstanding that over a period of six years the investor exceeds the 50% threshold.

One Time Offer

Once a shareholder has acquired a 50% shareholding and has made a tender offer or at that time was exempted from making a tender offer, the acquisition of additional shares does not require a tender offer to be made.

Compulsory Acquisition of a Minority Shareholding

There are no provisions under the Company Law or under the tender offer rules that permit a compulsory acquisition of the shares of minority shareholders.

Acquisition of a Substantial Shareholding - Debt to Equity

Exchanging debt for equity is dealt with in Article 35 of the Company Law which stipulates that a shareholder or any creditor that has a claim against a company cannot offset its rights to compensation against a payment obligation for shares, unless this is a claim recognized under the Company Law.

The following types of claims can be set off under the Company Law:

- Monies received by the company
- Tangible or intangible goods that can be valued
• Guarantee obligations (shares as payment by the company of such obligations)

• The company’s indebtedness to a guarantor as a result of a guarantee being enforced

Such set offs against the payment for shares can only be made with the prior approval of the general meeting of shareholders (it is possible to obtain general approval for such set offs or obtain approval on a case-by-case basis).

The articles of association of a company must be amended to ensure that the preemptive rights of shareholders do not apply to these set-off arrangements (see below).

Notices of set-off arrangements and the issue of shares need to be published in appropriate newspapers to ensure that interested parties are aware of the conversion.

Acquisition of a Substantial Shareholding - Private Placement

Decree of the Chairman of Bapepam-LK No. Kep-429/BL/2009, dated 9 December 2009, on the Increase of Capital Without a Rights Issue ("Regulation IX.D.4") provides that an issuer or a public company may increase its capital without giving preemptive rights to its shareholders (but such an issue is subject to prior approval of the general meeting of shareholders, either specifically or generally) in certain circumstances:

• if the increase of capital does not exceed 10% of the issued capital over a period of two years; or

• for any amount of new shares, if the primary purpose of the increase in capital is to improve the financial condition of the company for:

  - banks that receive loans from Bank Indonesia or a government agency that are more than 100% of the issued capital, or other conditions that result in a bank restructuring by authorized government agencies;

  - companies, other than banks, that have a negative net working capital with obligations exceeding 80% of those assets at the time of the general meeting of shareholders which approves the transaction; or

  - companies that fail or are unable to avoid failure to meet their obligations to non-affiliated lenders, provided that those unaffiliated lenders or investors agree to accept shares or convertible bonds to settle the loans concerned.
Such an issue of shares is exempt from the preemptive rights requirement but may be subject to the registration statement requirements for a public offering if the shares are issued in a manner that qualifies as a public offer under the Capital Markets Law.

In addition, however, the articles of association of the relevant company, if not already amended, will need to be amended to accommodate any generally approved private placement provision in a public company’s articles of association.

There are procedural requirements set out in Regulation IX.D.4 which are not covered here.

Acquisition of a Substantial Shareholding - Rights Issues

Rights issues are generally made on a preemptive basis with rights being offered to all shareholders (Decree of the Chairman of Bapepam No. Kep-26/PM/2003 - Regulation IX.D.1).

Offer to All Shareholders

If a public company wishes to issue and sell equity securities or issue convertible bonds or warrants, it must offer its existing shareholders the prior right to subscribe for these securities ("Rights Issue"). Each shareholder must be given a preemptive right to subscribe for such equity securities in proportion to its ownership percentage (except if the company issues dividend shares or bonus shares). Before making a Rights Issue, the company must submit a registration statement relating to the Rights Issue to the chairman of Bapepam-LK ("Registration Statement") and must have undertaken a legal audit of its affairs. Under current Indonesian regulations, the company may not proceed with the process until the Registration Statement (filed with Bapepam-LK) becomes effective.

Effectiveness of Issue

Unless otherwise stipulated by Bapepam-LK, the Registration Statement will become effective after the shareholders approve the Rights Issue at an extraordinary general meeting of shareholders.
Miscellaneous

The record date for shareholders who are entitled to subscribe for and purchase the rights is eight working days after the extraordinary general meeting of shareholders. Rights can be exercised at any time during the trading period and the certificate for the new shares (if the shares are still in script form) must be issued and made available within two working days after the rights are exercised.

If the securities underlying the rights are listed, the rights must also be registered on the Indonesian Stock Exchange, and the Indonesian Stock Exchange must automatically list the rights related to the listed shares. The rights can be transferable and tradable on the IDX. The listed rights can also be traded outside the IDX.

Any unsubscribed rights must be allocated by the company to shareholders that have previously applied to purchase excess rights. Shareholders applying for excess rights must make full payment on the second working day after the end of the trading period. The allotment must be completed within one working day after the payment period for the excess rights has ended. Any refund must be made by the company within two working days after the allotment date.

Standby Purchaser/Underwriter

Before making a Rights Issue, if the company seeks to raise a specific amount, the company must obtain a guarantee from a party, the standby purchaser, which agrees to purchase any remaining excess rights shares (“Remaining Excess Rights”) at a price which is at least equal to the exercise price. There are no restrictions on the identity of such a party.

The standby purchaser will be responsible for the discharge of its obligations to purchase any Remaining Excess Rights at the exercise price and must pay for the Remaining Excess Rights within two working days after the end of the trading period.

Consequently, in circumstances where the company seeks to raise a specific amount, another party may be able to secure a shareholding by acting as a standby purchaser and if this shareholding exceeds 50%, then a tender offer is not required.
Voluntary Delisting - Going Private

General

As Indonesian regulations do not have a compulsory acquisition procedure in a tender offer scenario (the 90% rule in some other jurisdictions), taking a public company private is not a simple procedure and needs to comply with policy and regulation applicable at the time.


The IDX Listing Rules offer two delisting options, namely Voluntary Delisting and Delisting by the Stock Exchange. In this guide, only voluntary delisting and the “go private” process are discussed.

Delisting remains a sensitive issue and is generally discouraged. While there is no law or regulation that prohibits a company from being delisted, Bapepam-LK and the IDX have had a long-standing policy of strongly discouraging it but, if undertaken in accordance with regulations, voluntary delistings can occur.

Under the IDX Listing Rules, delisting has clearly become the authority of the stock exchange alone. However, given that Bapepam-LK is required to monitor the capital markets and protect the interests of minority shareholders, its policy plays an important role in a voluntary delisting.

Voluntary Delisting (at the Request of a Public Company)

The following are the requirements for a voluntary delisting:

- A request for a delisting by a public company will only be accepted if its shares have already been listed on the Indonesian Stock Exchange for at least five years.
- The delisting plan must be approved by a general meeting of shareholders.
- The public company or another party (usually the majority shareholder) must buy shares from shareholders who do not agree with the resolution of the general meeting of shareholders.
In a voluntary delisting in relation to a “go private” process, all the shares owned by other shareholders must be bought by the majority shareholder or another party appointed by the majority shareholder (please also refer to Bapepam-LK Policy and Concerns on Go Private below).

- The purchase price for the shares will be the highest price of:
  - the nominal value;
  - the highest price reached in the regular market during the two-year period before the announcement of the general meeting of shareholders (as adjusted for any changes in capital in the last two years), plus a return on investment over the last two years (calculated in accordance with the IDX Listing Rules); or
  - the fair value based on an appraisal by an independent registered Bapepam-LK appraiser and appointed by the public company or the party who will purchase the shares and who has been approved by the general meeting of shareholders.

Delisting Procedures

Under Regulation No. I-I, the following are the procedures and steps that need to be followed:

- A delisting plan must be submitted to the IDX prior to the disclosure of information to the public. The delisting plan should include:
  - the reasons for the delisting;
  - the party who will buy the shares of the public; and
  - an estimation of the price of shares.

- Thereafter, the public company must publish the disclosure information to the public through at least one newspaper that has nationwide circulation. Publication of the disclosure information must occur simultaneously with the announcement of a general meeting of shareholders of the public company, and immediately after publication the disclosure information must be submitted to the IDX.

- If the general meeting of shareholders of the public company approves the delisting plan, then the public company must disclose information on the procedure for the buyback of shares through at least one newspaper that has nationwide circulation. The disclosure should include at least:
  - the purchase price of the shares;
- the name of the party that is going to buy shares and its relationship with the public company, if any (in a “go private” scenario, usually this will be the majority shareholder intending to take the company private);

- the period for the purchase of shares, which must be at least five exchange days after the date of the general meeting of shareholders of the public company being published in the newspaper; and

- the appointment of the member of the IDX that will act as the broker of the buyer.

All this information must be submitted immediately to the IDX.

- The public company must submit a request for the delisting to the IDX enclosing a report on the implementation of the purchase of shares and a legal opinion by an independent legal counsel, which states that the procedure of the purchase of shares has been completed in accordance with the current regulations.

- Thereafter, the exchange will suspend the public company’s shares.

- The delisting will only be effective after:
  - the public company fulfills all its obligations to the IDX;
  - the public company has paid the delisting fee, equivalent to twice the amount of last annual listing fee; and
  - the IDX consents to the delisting of the listed public company and announces the delisting.

**Bapepam-LK Policy and Concerns on “Go Private”**

There are no Bapepam-LK regulations on what is required in order to “go private” and consultation is required, given that policy varies from time-to-time. Bapepam-LK, however, has a policy requiring the following considerations to be addressed:

- A “go private process” must not contravene the public company’s articles of association and the prevailing provisions of the Capital Markets Law. Going private can only be done following a resolution of the general meeting of shareholders at which only independent shareholders can vote (i.e., the main shareholder seeking to take the public company private cannot vote).
• The process must not harm public investors, particularly with respect to determining the price. The buyback process must be smooth and emphasis must be place on the public’s interest.

• After going private, there cannot be more than 50 shareholders.

• Going private also includes a delisting from the IDX. In order to go private, the rules of the exchange, stated above, in addition to the Bapepam-LK policy, must be complied with.

• The result of the general meeting of shareholders resolving to go private must be reported to Bapepam-LK and announced to the public, at the latest, by the end of the second working day after the general meeting of shareholders approves the “go private” process, under, inter alia, Regulation No. X.K.1, Attachment to Decree of the Chairman of Bapepam No. Kep-86/PM/1996, dated 24 January 1996, regarding Disclosure Requirements.

Changes to Articles of Association

The change in status from a public company to a private company will require the amendment to the articles of association. Amendments require a resolution of the general meeting of shareholders and then approval by the Minister of Law and Human Rights. Such amendment of the articles of association will be deemed effective on the obtainment of the approval from the Minister of Law and Human Rights. Amendments must be attended by shareholders representing and approved by at least two-thirds of the voting shares cast legally at a general meeting of shareholders.

Insider Trading

Indonesian insider trading regulations are contained in Articles 95 to 99 of the Capital Markets Law and are quite restrictive. Generally, Indonesian insider trading regulations provide that individuals who obtain insider information owing to their positions or professions or due to business relationships with a public company are considered to be insiders for a period of six months after the relationship ceases. Insiders in possession of insider information are prohibited from buying or selling securities of the issuer or public company or of other companies engaged in transactions with the issuer or public company.
The following individuals will be considered as insiders with respect to insider trading:

- Commissioners, directors or employees of a public company
- The principal shareholder(s) of a public company
- Individuals who, due to their position, profession or business relationship with a listed or public company, are able to obtain inside information
- Parties who, within the last six months of the relevant date, fell into one of the above categories

“Insider information” means any material information of a price-sensitive nature that an insider has that is not yet available to the public.

The provision also covers tippees by prohibiting insiders from influencing other parties to trade certain securities or to provide insider information to a party that would reasonably be expected to use it in the trading of securities. Any party that violates the above provision is subject to a prison term of up to 10 years and a maximum fine of IDR15 billion, unless it can be proven that the insider information was not unlawfully obtained and that this information was disclosed by the issuer or a public company without restriction. Bapepam-LK has the authority to investigate possible insider trading offenses and will generally deem information obtained from a due diligence as insider information. Bapepam-LK further takes the view that if the insider information constitutes material information, the public company would be obliged under Regulation X.K.1 (see below) to announce it to the public immediately. Notwithstanding its authority to investigate insider trading allegations, Bapepam-LK will typically use the following indicators to determine whether insider trading has taken place:

- A drastic movement in share price
- A drastic change in the trading volume of shares

As a matter of practice, parties are required to sign certain confidentiality agreements that closely follow the provisions on insider trading as found in the Capital Markets Law to avoid possible allegations or charges of insider trading.

However, Regulation No. XI.C.1 on Securities Transactions not Prohibited for Insiders ("Decree of the Chairman of Bapepam No. Kep-58/PM/1998") dated 2 December 1998, exempts off-the-exchange securities transactions between insiders of the same issuer or public company having the same insider information, or off-the-exchange securities transactions between an insider in
possession of insider information and a non-insider, from the insider trading rule. Note that in the case of a transaction between an insider and a non-insider, additional requirements must be fulfilled in order for the exemption to apply. The additional requirements are as follows:

- All insider information must be disclosed to the non-insider.
- The non-insider cannot use the insider information other than for the purpose of a transaction with the said insider.
- The non-insider must make a written statement that all the insider information obtained will be kept confidential and will not be used for purposes other than the proposed securities transaction with the relevant insider.
- The non-insider cannot transact in the securities markets for a six-month period from the date that insider information has been obtained, other than with the relevant insider.

Based on this, the off-the-exchange transaction between principal shareholders that have the same insider information is not considered insider trading.

Disclosures by Public Companies/Substantial Shareholders

Accounts

Bapepam-LK regulations require publicly listed companies to publish their (unaudited) accounts every six months and their audited accounts annually. Those accounts must be in a form and contain information as stipulated by Bapepam-LK.

Substantial Shareholder Disclosure Requirements

Decree of the Chairman of Bapepam LK No. KEP-82/PM/1996 dated 17 January 1996 on Disclosure of Information by Certain Shareholders ("Regulation X.M.1"), provides that any party that owns 5% or more of the issued shares of a public company, is required to report to Bapepam-LK its ownership or any change within 10 days of the date on which the transaction takes place. The report must include at least the following information:

- The name, address and citizenship of the reporting party
- The number of shares purchased or sold
- The purchase or sale price per share
• The date of the transaction
• The purpose of the transaction

The report should correctly disclose the purpose for undertaking the transaction. For example, the purchase may be made for purely investment reasons, with no intention on the part of the buyer to exercise control or to change the management of the target.

Material Information

Decree of the Chairman of Bapepam-LK No. KEP-86/PM/1996 dated 24 January 1996 on Information to be Immediately Disclosed to the Public ("Regulation X.K.1"), provides that a public company must report to Bapepam-LK and make an announcement to the public (including to the stock exchange where the shares are listed) by the end of the second working day after the decision on or the existence of a material fact or information that might affect the value of the securities or the investment decision of an investor.

Regulation X.K.1 includes a change in control of management as one of the material events that must be reported to Bapepam-LK. If the plan of a prospective buyer to acquire a controlling stake in a public company is known to the board of directors concerned (e.g., because the directors are also shareholders who are selling to the prospective buyer), then the director is obliged (in his or her fiduciary duty to the company) to make an announcement of the buyer’s intention within the prescribed period if obtaining such an equity interest in the public company will likely be interpreted by the authorities as vesting in the buyer considerable control over the target company.

Material Transactions

Under the Decree of the Chairman of Bapepam-LK No. Kep-614/ BL/2011 dated 28 November 2011 on Material Transactions and Change of the Main Business Activities ("Regulation IX.E.2"), any transaction entered into by a public company with a value of 20% of equity of the company concerned ("Material Transaction") must follow certain requirements, including making certain announcements pertaining to the transaction and obtaining approval from a general meeting of shareholders. The express terms of Regulation IX.E.2 refer to the participation in companies, projects or certain business activities; purchase, sale, transfer, exchange of business segments or assets; lease of assets; lending or borrowing of money; provision of assets as collateral; and/or provision of corporate
guarantee exceeding the prescribed value. The calculation value should be determined using the most current of the following financial statements:

- The annual audited financial statements
- The midyear audited financial statements accompanied by an auditor’s report for limited review (at least with respect to the equity account)
- Interim audited financial statements (other than midyear interim financial statements), if any.

A Material Transaction with a value of 20% - 50% of a public company’s equity does not need to obtain shareholders’ approval.

However, the public company must announce the information on the Material Transaction to the public in at least one Indonesian-language daily newspaper having national circulation ("Announcement") and must contain the specific information required by the regulation.

The Announcement must be made, and the evidence of the Announcement including its supporting documents must be submitted to Bapepam-LK, at the latest two working days after the signing of the agreement relating to the Material Transaction.

A Material Transaction with a value exceeding 50% of a public company’s equity must obtain shareholders’ approval. In the shareholders’ meeting, the public company must provide information including an explanation, the consideration and the reasons for conducting the Material Transaction as well as the impact of the Material Transaction on the financial condition of the company.

For a Material Transaction that requires shareholders’ approval, the public company must fulfill the specific requirements of the regulation.

Exemptions from Regulation IX.E.2 include, but are not limited, to the following:

- Material Transactions between the public company and its subsidiary whose shares are at least 99% owned by the public company
- Corporate guarantees provided by the public company to other parties with respect to a transaction conducted by the public company’s subsidiary whose shares are at least 99% owned by the public company
- Loans obtained by the public company from banks as well as non-bank financial institutions.
- Material Transactions conducted by the public company which is within the main business activity of the public company
Material Transactions conducted by the public company with respect to assets which are directly used for the production process or the main business activity of the public company, and/or used to directly support the production process or the main business activity of the public company.

Material Transactions conducted by the public company the information on which has been fully disclosed in its prospectus.

If a listed company proposes to change its business it must likewise comply with the procedures set out in Regulation IX.E.2.

Connected or Related Party Transactions

Connected or related party transactions are regulated by the Decree of the Chairman of Bapepam-LK No. Kep-412/BL/2009, dated 25 November 2009 on Affiliated Party Transactions and Conflicts of Interest in Certain Transactions ("Regulation No. IX.E.1").

Transaction

The term transaction is defined as an activity in relation to:

- the granting of and/or obtaining of a loan;
- the acquisition, disposal of, or use of assets including guarantees of certain obligations;
- the acquisition, disposal of, or use of services or securities of a public company or a Controlled Company; or
- entering into a contract with respect to the activities mentioned above which is conducted in one transaction or in a series of transactions.

Affiliated Party Transactions

An Affiliated Party Transaction is defined as a transaction conducted by a public company or a controlled company of the public company ("Controlled Company") with an Affiliate of the public company or an Affiliate of the members of the board of directors, the members of the board of commissioners or the Principal Shareholders.

Affiliated Party Transactions can be divided into three types:

- Affiliated Party Transactions that require disclosure to the public
• Affiliated Party Transactions that do not require disclosure to the public but need to be reported to Bapepam-LK

• Affiliated Party Transactions that do not require disclosure to the public or do not need to be reported to Bapepam-LK (i.e., the exempted Affiliated Party Transactions)

Only the Affiliated Party Transactions that need to be disclosed to the public must be appraised by an independent appraiser.

Regulation No. IX.E.1 has lengthy provisions on the process and procedures that need to be followed and advice should be sought.

Conflict of Interest Transactions

A Conflict of Interest is defined as the difference between the economic interests of a public company and the personal economic interests of the directors, commissioners or the Principal Shareholders of the public company, which may cause losses to the public company. Under this definition, the key point is whether or not the board of directors and the board of commissioners consider that entering into the Transaction may cause losses to the public company. To support the decision, an independent appraiser may need to be appointed to appraise the Transaction and issue a fairness opinion.

If the transaction is considered a Conflict of Interest Transaction, a public company would need to obtain approval from its independent shareholders, as defined below, unless it qualifies as an exempted transaction. Regulation No.IX.E.1 requires the public company to prepare a circular on the Conflict of Interest Transaction for its shareholders, and sets the requirements for the circular. Independent shareholders are defined as shareholders having no conflict of interest with the transaction and must make a declaration to this effect.

Conflict of Interest Transactions must be approved by the independent shareholders representing at least more than half of all shares owned by the independent shareholders who are present in a general meeting of shareholders, where independent shareholders representing at least more than half of all shares owned by independent shareholders are present. If the above quorum and resolution requirements are not met, second and third meetings with more relaxed requirements could be held.

If the general meeting of shareholders does not approve the proposed Conflict of Interest Transaction, the proposed transaction cannot be proposed again within the 12 months following the date of the rejection by the general meeting of shareholders.
In addition to the disclosures, announcements and circulars, opinions of an independent appraiser, independent legal counsel and other measures may also be required either by Regulation No.IX.E.1 or as a matter of prudence to ensure that the course taken by the public company is defensible.

Exemptions

There are certain specific exclusions set out in Regulation No.IX.E.1 including transactions conducted by the public company where the value does not exceed 0.5% of the paid-up capital and is not more than IDR5 billion.

A Conflict of Interest Transaction between a public company and its Controlled Company whose shares are at least 99% held by the public company; or two or more Controlled Companies whose shares are at least 99% held by the Public Company, is now exempted from the requirement to obtain the approval from the shareholders. However, if such a transaction falls under the definition of an Affiliated Party Transaction, the transaction will need to be reported to Bapepam-LK (but does not need to be disclosed to the public and therefore no independent appraiser report is required).

Cautionary Note

The Capital Markets area is highly regulated and any activity in this area must be undertaken with appropriate advice.

Furthermore, investors should be aware of regulations affecting post- acquisition operational issues (including audit committees, rotation of auditors and independence of commissioners and financial advisers, among others).
## APPENDIX A - BRIEF COMPARISON OF MAJOR ISSUES IN MERGERS, CONSOLIDATIONS AND ACQUISITIONS

<table>
<thead>
<tr>
<th>Item</th>
<th>Merger</th>
<th>Consolidation</th>
<th>Acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax</td>
<td>Transfer of assets can be done at book value subject to prescribed conditions.</td>
<td></td>
<td>In an asset acquisition, VAT may apply (exemption available subject to conditions).</td>
</tr>
<tr>
<td></td>
<td>Gains on a revaluation of fixed assets are subject to final income tax at a rate of 10%, which can be paid over a maximum of five years starting from the year of revaluation (minimum 20% of the total due per annum).</td>
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</tr>
<tr>
<td>Item</td>
<td>Merger</td>
<td>Consolidation</td>
<td>Acquisition</td>
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<td>-------------</td>
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<tr>
<td>Procedure</td>
<td>The procedure is relatively simpler than an assets acquisition (followed by liquidation), as long as all creditors can be tactfully approached. However, it requires various proposals and plans to be prepared and approved by all organs of the companies involved (directors, commissioners and shareholders). It will increase the work given that some participants are public companies. The disclosure, fairness and transparency requirements will apply.</td>
<td>Similar to a merger</td>
<td>Asset acquisitions (followed by a liquidation process) set forth in the Company Law are more complicated, unless the “complicated liquidation procedures” will not be an issue in the proposed transaction.</td>
</tr>
<tr>
<td>Item</td>
<td>Merger</td>
<td>Consolidation</td>
<td>Acquisition</td>
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</tr>
<tr>
<td>Effective Date of Restructuring</td>
<td>The effective date is the date all necessary approvals from the Ministry of Law and Human Rights are received. If no approval is required for the amendments, the effective date will be the day of registration at Ministry of Trade (maximum 30-day process).</td>
<td>A consolidation (and the dissolution of the consolidating companies) becomes effective upon the date that the deed of establishment of the new fused company is approved by the Ministry of Law and Human Rights.</td>
<td>If Article 127 (7) of the Company Law is followed, the effective date is the date of the execution of deed of acquisition. The effective date for an assets acquisition is the date of the effectiveness of the sale and purchase of assets agreement.</td>
</tr>
<tr>
<td>Corporate Structure</td>
<td>Results in one company surviving</td>
<td>Results in new company being established</td>
<td>Does not achieve purpose of one single entity</td>
</tr>
<tr>
<td></td>
<td>All assets and liabilities of the merging companies will be transferred to the surviving company, and the other merging companies will be dissolved, by operation of law, on the merger date (without prior liquidation).</td>
<td>All assets, liabilities and equities of the consolidating company will be transferred to the new company.</td>
<td></td>
</tr>
<tr>
<td>Item</td>
<td>Merger</td>
<td>Consolidation</td>
<td>Acquisition</td>
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<tr>
<td>Under the stock exchange rules, if the merger involves one or more listed companies, the shares of the surviving company must continue to be listed. There are set procedures under regulation.</td>
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<td></td>
</tr>
<tr>
<td>Timing</td>
<td>Anticipated timing is a minimum of three months (and will be longer if there is pre-merger restructuring)</td>
<td>Similar to merger</td>
<td>An acquisition is as time consuming as a merger/consolidation</td>
</tr>
<tr>
<td>Creditors and Minority Shareholders</td>
<td>Creditors and the minority shareholders have the right to object to a merger.</td>
<td></td>
<td>Creditors and the minority shareholders have the right to object to an acquisition.</td>
</tr>
<tr>
<td>Licences</td>
<td>All licences are theoretically transferred to the surviving company, although certain registration may be required to perfect the licences.</td>
<td>Licences need to be reapplied as a new company is established as a result of consolidation.</td>
<td>Licences will remain the same (please note that in an asset acquisition licences are not transferable and need to be applied for again).</td>
</tr>
</tbody>
</table>
JAPAN
It should be noted that the material in this book is designed to provide general information only. It is not offered as advice on any particular matter, whether it be legal, procedural or other, and should not be taken as such. The laws and regulations summarized in this book are current as of 30 November 2012. The authors expressly disclaim all liability to any person in respect of the consequences of anything done or omitted to be done wholly or partly in reliance upon the whole or any part of the contents of this book. No reader should act or refrain from acting on the basis of any matter contained in it without seeking specific professional advice on the particular facts and circumstances at issue.

This may qualify as “Attorney Advertising” requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome.
Historically, the volume of mergers and acquisitions (“M&A”) has been relatively low in Japan compared to other major industrialized markets. The last decade, however, has seen significant developments in the Japanese M&A market.

First, the volume of M&A transactions increased enormously in the early part of the decade, peaking at over 2,500 transactions in 2006, which is five times the volume compared to 1996. The biggest driver of this increase has been in-country transactions, i.e., transactions between Japanese corporations. The volume of inbound transactions also rose during this period but fell sharply following the global financial crisis (“GFC”). The GFC, however, triggered a wave of outbound transactions as Japanese corporations took advantage of comparatively robust balance sheets, lower prices and less competition for offshore assets to expand their presence in overseas markets.

Second, private equity funds, both domestic and foreign, became significant players in the M&A market, driving the growth of the buy-out industry and acquisition finance in Japan. The development of this industry, in turn, ushered in public-to-private transactions.

Third, the decade saw a series of major corporate law reforms, making it possible to implement a range of new M&A transaction structures such as triangular mergers, and prompting several high-profile corporate takeover attempts and a wave of poison pill plans. New squeeze-out structures made possible by the introduction of class shares under the Companies Act are also credited with driving the growth of going-private transactions from the latter part of 2006.
Japanese M&A data for 2012 suggest that the overall decline in transaction volumes is beginning to slow down and that continuing growth in outbound transactions may drive overall deal value higher in 2013.

Legal Environment

The Japanese legal system is a civil law system modeled principally on German and French law. Some specialized legislation, such as the FIEA, is modeled after US law.

The primary sources of Japanese law are codes and statutes. Key codes and statutes applicable to M&A include the Companies Act, the FIEA and the Anti-Monopoly Act. Foreign investment is subject to certain reporting and, in limited instances, approval procedures under the Foreign Exchange and Foreign Trade Act ("FEFTA").

As in many civil law jurisdictions, in most cases the primary codes and statutes set out only the broad legal principles. These are supplemented, to some extent, by case law and subordinate legislation.

However, for cultural and other reasons, the occurrence of commercial litigation is relatively low in Japan and in many cases there is not an extensive body of case law upon which to rely.

Subordinate legislation may take the form of cabinet orders, enforcement orders, ministerial orders and other rules formulated by government agencies. Though these regulations help articulate the law, considerable discretion is often vested with the agency charged with administering the relevant law.

Investment Overview

Japan is the world’s third largest economy. In the past, specific sectors that have experienced significant M&A and investment activity include financial services, including insurance and securities brokerage; telecommunications; automotive; retail; and information technology.
A business acquisition may proceed by way of a share acquisition, an asset acquisition, a corporate spinoff (kaisha bunkatsu), a merger or a joint venture.

In Japan, an acquisition usually takes the form of either an asset acquisition, which involves purchasing the assets of a business, or a share acquisition, which involves purchasing the shares of the company that owns the business. However, mergers and joint ventures are also widely used for business acquisition purposes. The following is a brief overview of the key features and elements of each type of transaction.

**Share Acquisitions**

An acquisition of shares in a Japanese company may proceed by way of any one or a combination of several different types of transaction, depending on:

- whether the company is privately owned or a listed company;
- whether, in the case of a private company, it is wholly owned or there are minority shareholders;
- whether the acquisition involves the purchase of existing shares or newly issued shares;
- whether, if the shares are existing shares, they are held by a Japanese corporation or a non-Japanese corporation; and
- the level of control that is sought if the company is a listed company (see box: Share Acquisitions of Listed Companies).
If the company is a listed company, depending on the level of control sought, the acquisition may involve one or a combination of several different types of transactions, including:

- the purchase of existing stock on- or off-market;
- the purchase of stock subscription options on- or off-market;
- the purchase of stock from a major stockholder or stockholders;
- the issue of new shares; and/or
- a share exchange (kabushiki kokan) and share transfer (kabushiki iten).

More detailed information regarding takeovers of Japanese listed companies is set out in the section on Acquisition of a Substantial Shareholding.

Appendix A sets out a brief summary of the consequences of the different levels of share ownership.

**Asset Acquisitions**

The Companies Act recognizes two types of business transfer: one that involves the transfer of “all or substantially all” of a Japanese company’s business, and one that does not.

In both cases, if the transaction involves the disposition or acquisition of “important property,” board approval is required by either the vendor or the purchaser or, in some cases, by both parties. Whether a transaction involves important property or not will be determined based on the price of the assets, the proportion of the assets relative to the company’s total assets, the purpose of the transaction, the terms and conditions of the transaction, and past practice.

In addition, a business transfer involving “all or substantially all” of a Japanese company’s business will be subject to a special resolution of the vendor’s shareholders. A special resolution is adopted by a two-thirds majority vote of the shareholders present at a general meeting of shareholders attended by shareholders holding more than one-half of the total shareholder voting rights of shareholders who are eligible to exercise voting rights at a general meeting of shareholders. If the business transfer involves the transfer of all of the Japanese company’s business, a special resolution of the purchaser’s shareholders will also be required.
The distinction between the two different types of business transfer is not always clear. For example, a sale by a company of a single plant, operating division or branch office may be regarded as a transfer of “substantially all” of its business. However, the question is usually determined on the basis of an objective assessment of the relative importance of the business sold compared with the company’s overall business (e.g., as a proportion of the company’s total amount of sales, earnings and workforce).

In practice, many purchasers tend to proceed cautiously when an asset acquisition is involved. It is common for purchasers to interpret the scope of the business transfer provisions widely and to insist on a special shareholders’ resolution by the vendors’ shareholders (i.e., interpreting the transaction as involving a transfer of “substantially all” of the vendor’s business) to avoid violating the Companies Act when the value of the assets is more than one-fifth of the total assets of the vendor. However, an asset transfer involving only receivables or securities for investment will be classified as an asset acquisition that does not involve a business transfer, even if the total value of the assets sold is relatively high.

Company Splits

The Companies Act provides for two types of company split:

- An incorporation-type company split (shinsetsu bunkatsu) in which a new company is incorporated by operation of law and acquires the assets and liabilities divested by the company undergoing the split

- An absorption-type company split (kyushu bunkatsu) in which an existing company acquires or “absorbs” the assets and liabilities divested by the company undergoing the split

Mergers

There are two types of merger available under the Companies Act:

- Merger by absorption, where the acquirer takes over all of the assets and liabilities of the target company and the target company is dissolved

- Merger by incorporation, where the assets and liabilities of both parties are acquired by a newly incorporated third party and both parties are dissolved

Merger by absorption is by far the most common method used in Japan. A merger will usually proceed by way of an issue of shares in the surviving company to the shareholders of the target company. A merger is often used to rationalize the operations of subsidiary entities. Cash-out mergers, involving mergers by absorption, is also allowed under the Companies Act.
The Companies Act does not currently permit mergers directly between foreign corporations and Japanese corporations. However, there are provisions under the Companies Act that permit acquisitions of Japanese corporations using shares in foreign companies (so called triangular mergers). Subject to certain Japanese tax law requirements, triangular mergers can take place by way of an allocation of the foreign company’s shares owned by its Japanese subsidiary (the surviving company) to the shareholders of the target company (the dissolving company).

Joint Ventures

Commercial considerations will dictate whether a transaction will be a 100% acquisition or a joint venture. For example, a joint venture is often preferred where access to local distribution networks and marketing know-how is sought, where the market is highly regulated or where the market is dominated by a small number of powerful players. In the case of an incorporated joint venture, the constitution of the company is drafted or amended to provide for issues of particular importance to the co-venturers to be determined by a special majority, restrictions on share transfers, and the resolution of any deadlock that may arise between the co-venturers.

Share Versus Asset Acquisition

Share Acquisition

Advantages for Vendor

The sale of the shares of the target company involves the divestiture of the target, together with all the liabilities, including contingent liabilities. Under an asset acquisition, the vendor retains all liabilities not assumed by the purchaser.

A sale of shares is often simpler than a sale of assets. In an asset sale, it is necessary to separately deal with each category of asset and liability. Contracts must be individually assigned to the purchaser and, where necessary, third party consents obtained.

Advantages for Purchaser

A purchase of shares is often simpler and less expensive.

A purchase of shares is not subject to any consumption tax or other indirect/transfer taxes, and will not trigger any real property tax or registration tax liability.  

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1 Note that the issuance of any share certificates is subject to stamp duty.
Any net losses, reserves and other allowances of the target are preserved. The consent of transferring employees is not required. Under an asset acquisition, the parties must obtain the consent to the transaction of the employees who will be transferred by the transaction.

Asset Acquisition

Advantages for vendor
The vendor may select more easily which assets it wishes to divest (and the vendor may find it desirable to retain the corporate entity in order to utilize tax losses).

Advantages for purchaser
The purchaser can be more precise about the extent of liabilities being assumed. This is particularly important where there is concern relating to contingent or undisclosed liabilities of the company for which adequate provision cannot be made at the time of purchase.

The purchaser can depreciate the assets acquired, including goodwill (subject to statutory limits on what can be treated as goodwill and the period over which it can be depreciated).

Company Split
Company splits are often used as an alternative structure to asset transfers because they are a more efficient structure from a procedural perspective (no need to obtain third party or employee consents - see also “Employment Issues”) and also from a tax perspective (see “Taxation Issues”).

Foreign Ownership Restrictions
Thresholds have been established with respect to foreign ownership in certain industries. These rules vary for individual companies within these industries and should be checked at the time an acquisition is contemplated.

The major industries to which these rules apply include the following:

**Telecommunications** - Foreign investors are permitted to acquire 100% of the shares of all Japanese telecommunications companies, except for Nippon Telegraph and Telephone East Corporation (NTT-East), Nippon Telegraph and Telephone West Corporation (NTT-West), and Nippon Telegraph and Telephone Corporation (NTT, being the holding company of NTT-East and NTT-West). Less than one-third of all of the voting rights of NTT may be foreign owned, and NTT-East and NTT-West are required to be owned by NTT.

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2 If the target company has a labor union, the transaction may be subject to a contractual or other commitment to give prior notice to or to consult with or even seek the consent of the union.
Airlines - Foreign investors are permitted to acquire 33.3% of all voting rights of Japanese airline companies.

Broadcasting - Foreign investors are permitted to acquire less than 20% of all voting rights in general broadcasting and communications companies and other similar companies. The regulations relating to broadcasting such as cable, satellite and similar companies are technical and fluctuate more than other regulations, and it is wise to confirm these restrictions prior to any substantial acquisition in such entities.

Foreign individuals and companies may still invest in the above companies beyond the maximum levels detailed above. However, they will not be able to be registered as shareholders and will therefore not be afforded the usual rights given to shareholders (e.g., voting rights and dividend rights).
Foreign Investment Restrictions

Foreign investment in Japanese companies and businesses is regulated under the FEFTA.

Certain reporting or approval requirements may apply to direct inward investments depending on:

- the jurisdiction in which the investor is located (i.e., whether it is an approved country or not);
- the industry in which the target company or business operates (i.e., whether it is a regulated or a non-regulated industry); or
- the nature of the particular asset involved in the case of asset acquisitions.

Share Acquisitions

**General case** - A foreign investor, typically a foreign corporation, will be required to file an after-the-fact report with the Minister of Finance ("MOF") and other relevant ministers through the Bank of Japan ("BOJ") by the 15th day of the month following the month in which the investor acquires shares in a Japanese company.

The filing of this report is generally regarded as a mere formality and does not require extensive disclosure of information.
**Exceptional case** - A foreign investor that purchases any shares in a company in Japan will be required to file a notification with the MOF and any other relevant ministers through the BOJ within six months prior to the acquisition, and file a report with the MOF and any other relevant ministers through the BOJ no later than 30 days after the acquisition if either:

- the investor is located in a jurisdiction that is not included in the MOF list of designated jurisdictions;
- the target company is engaged in business in a regulated industry; or
- the investor is Iranian and acquires shares in a company which operates a business in which Iranian investment is prohibited.

Regulated industries include telecommunications (i.e., involving telecommunications carriers required to be registered under Article 9 of the Telecommunications Business Act), agriculture, fisheries, petroleum, leather goods, aerospace, nuclear power, gunpowder and armaments.

**Exemption** - Neither an after-the-fact report nor a prior notification is required if, as a result of the acquisition, the investor and any related companies do not in aggregate hold 10% or more of the issued shares in a company (whether or not the company is listed).

**Offshore Share Acquisitions**

A foreign investor that acquires shares in a non-listed company from another foreign investor is not required to file a prior notification or after-the-fact report regarding the acquisition.

A foreign investor that acquires shares in a listed company from another foreign investor will also not be required to file a prior notification or after-the-fact report regarding the acquisition if, as a result of the acquisition, it and any related companies hold less than 10% of the listed company’s issued shares. However, a foreign investor that proposes to acquire 10% or more of the issued shares of a listed company (including shares held by any related companies) will be required to comply with:

- the exceptional case filing obligations outlined above if the foreign investor disposing of the shares previously filed a prior notification under the FEFTA; or
- the general case filing obligation outlined above if the original acquisition was not subject to a prior notification requirement.
If the foreign investor disposing of the shares previously filed a prior notification under the FEFTA, that foreign investor will be required to file an after-the-fact report with the MOF. This requirement applies to disposals of shares in non-listed as well as listed companies.

**Asset Acquisitions**

If a foreign investor acquires assets directly from a Japanese vendor, the acquisition will be subject to certain reporting requirements under the FEFTA. The reporting requirements differ depending on the particular asset involved. For example, subject to certain limited exceptions, non-residents must report acquisitions of real property located within Japan to the MOF through the BOJ within 20 days after the acquisition. Personal property, other than gold bullion, is generally exempt from these requirements.

**Mergers**

The Companies Act does not currently provide for mergers between foreign corporations and Japanese companies. A foreign investor can only participate in a merger, as the acquiring party, through a wholly owned or controlled Japanese subsidiary. If a foreign investor proposes to establish a new company in Japan with a view to acquiring the assets of a Japanese company through a merger, the acquisition of shares in the new company will be subject to the reporting requirements and restrictions that apply under the FEFTA for share acquisitions (see above). As noted above, however, there are provisions of the Companies Act which permit acquisitions of Japanese corporations using shares in foreign companies (so called triangular mergers).

**Changes of Business Purposes**

A change of a foreign-held company’s business purposes will also trigger a FEFTA prior notification requirement if that change relates to a regulated industry. A change not relating to a regulated industry is not subject to any prior notification or reporting requirement.

**Exchange Controls**

One of the stated aims of the FEFTA is to subject foreign exchange and foreign trade to the minimum necessary controls and regulation. In keeping with this aim, capital flows relevant to mergers and acquisitions in Japan are largely free of government controls.
However, cash remittances of more than JPY30 million into or out of Japan must be reported to the MOF. This reporting obligation falls on residents only. In practice, however, the Japanese bank involved in the transaction will usually prepare and file a report on its customer’s behalf.

The repatriation of profits and dividends by branch and subsidiary forms is unrestricted in Japan. Bond issues, whether overseas by Japanese residents or by foreign residents in Japan, do not require government approval. However, issues involving amounts of JPY100 million or more may be subject to an after-the-fact reporting requirement.

**Competition Law**

The Anti-Monopoly Act prohibits M&A if, as a result, competition in any particular market may be substantially restrained or if the merger or acquisition involves unfair trade practices. To make this prohibition effective, the Anti-Monopoly Act imposes certain reporting and approval requirements in relation to certain M&A transactions.

Broadly speaking, transactions involving share acquisitions, business transfers, asset acquisitions, mergers and corporate spinoffs that meet thresholds set out in the Anti-Monopoly Act are subject to prior notification to the Fair Trade Commission (“FTC”).

**FTC Review**

The FTC may review a direct or indirect acquisition of a Japanese company or business, and has the power to order the parties to a transaction deemed as substantially restraining competition in a particular market to take a range of remedial steps in order to restore competition, including the divestiture or transfer of a business.

The FTC’s Guidelines on the Application of the Antimonopoly Act to Reviewing Business Combinations outline the circumstances in which a proposed merger or acquisition may or may not be regarded as substantially restraining competition in a particular market.

The guidelines refer to the Herfindahl-Hirschmann Index (“HHI”) which is calculated as the sum of the squared market share of each company in a particular market. If the business combination only involves two parties, the HHI increment can be calculated by doubling the sum of the squared market share of each company group.
The guidelines specifically state that a share acquisition, asset acquisition (including a business transfer) or merger is unlikely to be deemed to have an anti-competitive effect where:

- the HHI after the business combination is not more than 1,500;
- the HHI after the business combination is more than 1,500 but not more than 2,500 while the HHI increment does not exceed 250; or
- the HHI after the business combination is more than 2,500, while the HHI increment does not exceed 150.

Amendments to the guideline which came into force on 1 July 2011, abolished the system of prior informal consultation under which the FTC granted informal clearance to difficult transactions before the parties formally filed a notification.

Under the amended Guideline, the FTC reviews proposed business combinations within the framework of the formal notification system under the Antimonopoly Act and no longer grants informal clearance in response to a voluntary consultation prior to a filing.

Restrictions on Financial Institutions

The Anti-Monopoly Act prohibits banks from owning more than 5% and insurance companies from acquiring more than 10% of the issued voting shares of any Japanese company. The prohibition applies whether the acquirer bank or insurance company is incorporated in Japan or overseas. However, this prohibition does not apply where prior permission is obtained from the FTC or where the acquisition falls within the scope of certain exemptions (e.g., pursuant to the exercise of security rights) provided under the Anti-Monopoly Act.

Reporting and Approval Requirements under the Anti-Monopoly Act

Under the Anti-Monopoly Act, a prior notification must be filed with the FTC in relation to mergers, asset acquisitions, share acquisitions, certain company splits and joint share transfers which meet certain thresholds set out in the Act.

The parties to a transaction that requires a prior notification filing are prohibited from effecting the transaction for a period of 30 days after the filing. However, the FTC has the power to shorten the waiting period. The FTC also has the power to ask the parties to submit additional information regarding the transaction.
If the FTC asks the parties to submit additional information during the 30-day waiting period, it may still take action in relation to the transaction even after the 30-day waiting period until the later of 120 days from the date of acceptance of the initial notification, or 90 days from the date of acceptance of the additional information.

**Share Acquisitions**

The acquiring company must file prior notification with the FTC no later than 30 days before completion of the share acquisition, where:

- the total amount of domestic sales\(^1\) of the acquiring company (whether a domestic or foreign company) and the other companies in the combined group of companies\(^2\) exceeds JPY20 billion;
- the total amount of domestic sales of the target company and its subsidiaries exceeds JPY5 billion; and
- as a result of the acquisition, the aggregate percentage of the total voting shares of the target company held by the acquiring company and the other companies in the combined group of companies exceeds 20% or 50%.

An acquisition of shares on incorporation of a wholly owned subsidiary is not subject to this reporting requirement.

**Business and Asset Acquisitions**

The acquiring company must file prior notification with the FTC no later than 30 days before completion of the acquisition where:

- the total amount of domestic sales of the acquiring company (whether domestic or foreign) and the other companies in the combined group of companies exceeds JPY20 billion;
- if the acquisition involves the company’s entire business, the company’s total amount of domestic sales exceeds JPY3 billion; and
- if the acquisition involves a material part of the company’s business or all or a material part of the fixed assets used in the company’s business, the total amount of domestic sales related to the target business or fixed assets exceeds JPY3 billion.

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1. The phrase “total amount of domestic sales” means the sum of the domestic sales of all of the companies that belong to the combined group of companies.
2. The phrase “combined group of companies” means a group that consists of a company and its subsidiaries and the ultimate parent company of the company, if any, and the subsidiaries of the ultimate parent company (excluding that company and its subsidiaries).
An asset transfer between a parent company and a subsidiary or between two or more subsidiaries of the same parent is not subject to the foregoing prior notification requirement.

**Mergers**

Both parties to a merger must file a prior notification with the FTC no later than 30 days before the completion of the merger where:

- the total amount of the domestic sales of the combined group of companies to which one company belongs exceeds JPY20 billion; and
- the total amount of domestic sales of the combined group of companies to which the other company belongs exceeds JPY5 billion.

A merger between a parent company and a subsidiary or between two or more subsidiaries of the same parent is not subject to the foregoing prior notification requirement.

**Company Splits**

In company splits involving multiple transferors, all parties (i.e., including the transferee entity) must file a prior notification with the FTC no later than 30 days before the completion of the company splits where certain thresholds are met. The applicable thresholds are summarized in the following table.

<table>
<thead>
<tr>
<th>Summary of FTC Filing Thresholds for Company Splits Involving Japanese Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Joint Incorporation-Type Company Split</strong></td>
</tr>
<tr>
<td>[ involves two or more Japanese companies transferring business to a newly established company (“NewCo”) ]</td>
</tr>
<tr>
<td>(a) All business of a transferor company is transferred to NewCo + Total amount of domestic sales of the combined group of companies to which that transferor company belongs exceeds JPY20 billion</td>
</tr>
<tr>
<td>(b) A material part of the business of a transferor company is transferred to NewCo + Total amount of domestic sales of that business exceeds JPY10 billion</td>
</tr>
</tbody>
</table>

<p>| and | and |</p>
<table>
<thead>
<tr>
<th>All business of another transferor company is transferred to NewCo +</th>
<th>Material part of business of another transferor company is transferred to NewCo +</th>
<th>All business of another transferor company is transferred to NewCo +</th>
<th>Material part of business of another transferor company is transferred to NewCo +</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total amount of domestic sales of a combined group of companies to which that transferor company belongs exceeds JPY5 billion</td>
<td>Total amount of domestic sales of that business exceeds JPY3 billion</td>
<td>Total amount of domestic sales of the combined group of companies to which that transferor company belongs exceeds JPY5 billion</td>
<td>Total amount of domestic sales of that business exceeds JPY3 billion</td>
</tr>
</tbody>
</table>
## Summary of FTC Filing Thresholds for Company Splits Involving Japanese Companies

### Absorption-Type Company Split

(involves two or more Japanese companies transferring business to an existing company (Transferee Company))

<table>
<thead>
<tr>
<th>(a)</th>
<th>(b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>One company transfers to Transferee Company either:</td>
<td>One company transfers to Transferee Company either:</td>
</tr>
<tr>
<td>All of its business + Total amount of domestic sales of the combined group of companies to which that company belongs to exceeds JPY20 billion</td>
<td>Material part of its business + Total amount of domestic sales of that business exceeds JPY10 billion</td>
</tr>
<tr>
<td>or</td>
<td>or</td>
</tr>
<tr>
<td>All of its business + Total amount of domestic sales of the combined group of companies to which that company belongs to exceeds JPY5 billion</td>
<td>A material part of its business + Total amount of domestic sales of that business exceeds JPY3 billion</td>
</tr>
<tr>
<td>and</td>
<td>and</td>
</tr>
<tr>
<td>Total amount of domestic sales of the combined group of companies to which the Transferee Company belongs exceeds JPY5 billion</td>
<td>Total amount of domestic sales of the combined group of companies to which the Transferee Company belongs exceeds JPY20 billion</td>
</tr>
</tbody>
</table>

In the case of a joint incorporation-type company split (kyodo shinsetsu bunkatsu) or an absorption-type company split (kyushu bunkatsu) involving two or more foreign companies transferring all or a part of their businesses to a Japanese company, the above conditions apply except that references to total assets and total sales should be read as references to total domestic sales (i.e., sales turnover in Japan).
A company split between a parent company and a subsidiary or between two or more subsidiaries of the same parent is not subject to the foregoing prior notification requirement.

**Joint Share Transfers**

In the case of a joint share transfer, all parties must file notification with the FTC no later than 30 days before the completion of the joint share transfer where:

- the total amount of the domestic sales of the combined group of companies to which any one of the companies belongs exceeds JPY20 billion; and
- the total amount of the domestic sales of the combined group of companies to which the other company belongs exceeds JPY5 billion.

**Securities Law Issues**

Securities transactions are regulated under the Financial Instruments and Exchange Act ("FIEA").

The FIEA regulations relating to securities transactions are complex. The filing and reporting requirements which apply to securities transactions under the FIEA are summarized below.

**Public Offerings**

Under the FIEA, an issuer whose securities are the subject of a “public offering” will be required to file a securities registration statement with the relevant local finance bureau.

**Primary and Secondary Offerings**

The FIEA rules distinguish between two types of offering, i.e., the offering of new securities for subscription (a “primary offering”) and the offering of securities that have already been issued (a “secondary offering”). The foregoing requirement applies to both types of public offering but certain securities transactions are excluded from the scope of a public offering in the form of a “secondary offering,” hence the distinction.
Specifically, the requirement to file a securities registration statement is triggered where there is a primary offering or secondary offering of securities constituting a “public offering” as shown in the following table:

<table>
<thead>
<tr>
<th>Type of issuer</th>
<th>Public company</th>
<th>Private company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scope of offering -</td>
<td>Any number of persons</td>
<td>50 or more persons</td>
</tr>
<tr>
<td>constituting a “public offering”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Registration requirement</td>
<td>Required if amount of the offering is ¥100 million or more (not required if the offer is made by a shareholder)</td>
<td>Required if amount of the offering is JPY100 million or more</td>
</tr>
</tbody>
</table>

For purposes of these rules, a “public company” is a company:

- which has filed a securities registration statement for a past public offering of its shares; or
- whose shares are publicly traded on an exchange market in Japan or held by 1,000 or more shareholders.

Exclusions

Securities transactions excluded from the scope of a public offering in the form of a secondary offering, and therefore which do not require the issuer to file a securities registration statement, include:

- a transfer of shares by a shareholder who is not a principal shareholder, i.e., a shareholder holding 10% or more of the voting rights of the issuer;
- a transfer of shares by a shareholder which is not a subsidiary of the issuer; and
- under current practice, certain “negotiated” share transfers by a shareholder.
Private Placements

Securities transactions which are not subject to the registration requirement under the FIEA, i.e., non-public offerings of securities or “private placements,” include:

- A primary or secondary offering of securities in a private company to less than 50 persons [small private placement]; and
- A primary or secondary offering of securities to in a private company qualified institutional investors subject to certain resale restrictions.

Reporting and Registration Requirements

Public offerings are subject to the following reporting and registration requirements:

**Securities Notice**

If the total amount of the offering is greater than JPY10 million but less than JPY100 million, the issuing company must submit a securities notice to the relevant local finance bureau prior to the offering.

**Registration Statement**

If the total amount of the offering is JPY100 million or more, the issuing company must, in principle, file a securities registration statement with the relevant local finance bureau generally at least 15 days prior to the offering.

**Securities Reports**

Once a company has filed a securities registration statement in relation to a public offering, the company is then required to file securities reports on an annual and semi-annual basis subject to certain limited exemptions. If the company has its shares listed on an exchange market in Japan, is required to file securities reports on a quarterly basis.

**Share Exchanges**

Corporate spinoff, merger, stock swap and stock transfer transactions involving exchange of shares in a public company with shares in a company that is not a public company are also subject to the registration requirement under the FIEA. Specifically, the non-public company is generally required to file a securities registration statement prior to the commencement of the transaction.
Specific Industry Regulation

In certain industries, the relevant regulatory authority may have to be notified and in some instances its consent or approval sought in relation to an acquisition or merger. For example:

**Telecommunications** - In the case of a transfer of the whole of a telecommunications business, a merger or a corporate break-up of a telecommunications carrier, an after-the-fact notice must be provided without delay to the Minister of Internal Affairs and Communications.

**Securities Dealers** - In the case of M&A involving securities dealers (in the case of a share acquisition, only where a majority of shares is to be acquired), an after-the-fact notice must be provided without delay to the competent Local Finance Bureau. In the case of acquiring 20% or more of the voting rights in a securities dealer, an after-the-fact notice must be made without delay to the competent Local Finance Bureau.

**Banks** - M&A involving banks are subject to the approval of the Commissioner of the Financial Services Agency. In the case of an acquisition of more than 5% of the voting rights in a bank, an after-the-fact notice must be made within five days to the competent Local Finance Bureau, and acquiring 20% or more of the voting rights in a bank is subject to the approval of the Commissioner of the Financial Services Agency.
The types of corporate approvals (i.e., board and shareholder approvals) required under the Companies Act depend on the nature of the transaction involved.

**Acquisitions of New Shares**

In general, if a person is to acquire new shares from the target company, the target company will need to determine whether the issuance in relation to the new shares involves:

- an issuance on a pro rata basis (see section titled Preemptive Rights Below);
- an issuance to specific parties; in this case, shareholder approval by the target company is required unless:
  - the target is a company that does not restrict any transfer of any class of shares (however, if the issue of new shares is at a particularly favorable price, shareholders’ approval will be required; see section on Particularly Favorable Price below.); or
  - the shareholders’ meeting of the target delegates the issue to the board of directors or the directors; and
- a public placement (see section titled Public Offerings above).

**Preemptive Rights Offering** - Under the Companies Act, shareholders in a company do not automatically have preemptive rights unless the company grants such rights to shareholders. When a company issues new shares to existing...
shareholders on a pro rata basis, the company will grant preemptive rights to all shareholders. If the target company is a company that does not restrict any transfer of any class of shares, board approval is sufficient to grant preemptive rights. If this is not the case, a special resolution of the shareholders of the target company is required unless the articles of incorporation of the target company allow the target company to approve the granting of preemptive rights by a board resolution or a directors’ resolution.

Increase of Authorized Capital - Shareholder approval by the target company is required, if the proposed issue requires a revision of the target’s authorized capital by amending the articles of incorporation of the target. If the target is a company that does not restrict any transfer of any class of shares, the target company must issue shares equivalent to at least one-quarter or more of its increased authorized capital.

Particularly Favorable Price - If the acquisition involves the issue of new shares at a particularly favorable price to any person, including existing shareholders, the Companies Act requires that the issue be approved by a special resolution of the shareholders of the target company, even if the target is a company with no restriction on share transfers. A special resolution is not required if the issuance is made to all of the existing shareholders on a pro rata basis (i.e., a rights offering) by a company that does not restrict the transfer of any class of shares. A “particularly favorable price” means a subscription price regarded as particularly low compared to a fair issue price. A fair issue price is generally regarded as the best price that the issuing company and existing shareholders might expect to get for the purposes of attracting additional capital funds. While there is no settled law in this area, there are guidelines to the effect that, in respect of public companies, a subscription price set approximately 10% below market value does not constitute a particularly favorable price. In the case of a closed company, a special resolution of shareholders is required for the issuance of new shares, even if the acquisition does not involve the issue of new shares at a particularly favorable price.

Acquisitions of Existing Shares

Board approval by the target company’s board of directors may be required where a transfer of shares is restricted under the target company’s articles of incorporation and the target company has a board of directors. Such restrictions are fairly common in closely held Japanese companies. If the target company’s articles of incorporation include a restriction on share transfer and the target
company does not hold a board meeting, then the transfer of shares will require a shareholders’ resolution of the target company.

The approval of the vendor’s board and the purchaser’s board will also be required if the sale/purchase of the target’s shares constitutes the disposition/acquisition of “important property” (see the discussion below).

Asset Acquisitions

As described in the section titled TYPES OF TRANSACTIONS above, vendor board approval will be required if the transaction involves the disposition of “important property.”

A special resolution of the vendor’s shareholder to approve the transaction will be required if the transaction involves the sale of all or a substantial part of the vendor’s business. If the value of the assets is less than one-fifth of the total assets of the vendor, a shareholders’ resolution is not required. This threshold may be lowered in the articles of incorporation.

Purchaser board approval will be required where the transaction involves the acquisition of important property or the financing of the transaction involves a large sum of money.

Purchaser shareholder approval will be required if the transaction involves the purchase of all of the vendor’s business. The transaction must be approved by a special resolution of shareholders. If the value of the business is less than one-fifth of the net asset value of the purchaser, a shareholders’ resolution is not required. This threshold may be lowered in the articles of incorporation.

If a party owns 90% or more of the shares of the other party (described as a special controlling relationship), the approval of the controlled company’s shareholders will not be required.

Asset Acquisition by Newly Incorporated Japanese Subsidiary

Foreign investors that wish to acquire Japanese assets through a recently established Japanese subsidiary should note that if the acquisition occurs less than two years after the subsidiary’s incorporation, it may be subject to the post-incorporation asset purchase (jigo setsuritsu) rules of the Companies Act.
The general rule is that if the subsidiary is less than two years old agrees to acquire property:

- existing before its incorporation;
- intended to be used on a continuing basis for purposes of the company’s business; and
- at a price equal to more than 20% (this percentage may be lowered in the articles of incorporation) of the company’s net asset value;

then a shareholders’ resolution is required to approve the asset acquisition in addition to a board resolution.

**Mergers**

A merger requires the approval of the board of directors and shareholders of both the acquirer and the target. However, if the total amount of the total number of shares issued by the acquiring company upon the merger multiplied by the net asset value per share of the acquiring company and the total book value of bonds or any other assets issued by the acquiring company upon the merger does not exceed one-fifth (which may be lowered by the articles of incorporation of the acquiring company) of the net asset value of the acquiring company, and there is no objection by any shareholder of the acquiring company holding a certain number of shares (as provided in the relevant ministerial decree), then the approval of the acquiring company’s shareholders is not required (known as a simplified merger).

Nonetheless, even if these conditions are met, the approval of the acquiring company’s shareholders will be required if the acquiring company assumes a net loss after the merger, or, the acquirer is a company whose articles of incorporation restrict the transfer of shares and issues shares on the merger.

If a party owns 90% or more of the shares of the other party (described as a special controlling relationship), the approval of the controlled company’s shareholders will not be required (a short-form merger).

Both the acquirer and the target must publish public notices regarding the merger to allow their creditors the opportunity to object to the proposed merger.
Third Party Consents

A transfer of business assets or change in control of a business will trigger requirements for notices to, or consents or approvals from, creditors, landlords, debenture holders, mortgagees and other third parties.

By contrast, a share acquisition will usually not require the consent or approval of third parties. However, depending on the terms of agreements to which the target company is a party, if there is a change of control, the acquisition may trigger notice requirements or even the termination of certain contracts without third party consent or waiver.

In a merger, the rights and obligations of the target company transfer automatically to the surviving entity. However, it may be necessary for the surviving company to perfect its rights under certain contracts (e.g., by giving the other party notice). In addition, a merger may also trigger change of control type provisions in the company’s third party contracts.

A company split is also not subject to any general law requirement to obtain third party consent. However, a company split may trigger notice or consent requirements if referenced in a contract to which the company undergoing the split is party.
Business Licenses

Many business licenses in Japan are non-transferable. In an asset acquisition, the acquirer will therefore often have to reapply for the necessary license, consent or permit required to carry on business in Japan.

Even in a share acquisition, the acquirer may find that while there is no requirement to reapply, it will be necessary to provide the licensing authority with the same information that the vendor was required to provide when it originally applied for the license.
Types of Transaction

From a tax perspective, there are generally two types of corporate transaction:

- Those provided under the Japanese Corporate Tax Law
- Those not provided under the Japanese Corporate Tax Law

These broad categories of corporate transaction are further subdivided into the following types of transfer:

- Those involving a transfer of business
- Those involving a transfer of shares (or shareholder)

Corporate transactions provided under the Japanese Corporate Tax Law are further subdivided into the following:

- Tax qualified reorganizations
- Non-tax qualified reorganizations
The following tables summarize how corporate transactions are categorized from a tax perspective:

(1) Reorganization methods provided under the Japanese Corporate Tax Law

<table>
<thead>
<tr>
<th>(a) Transfer of business</th>
<th>Merger</th>
<th>(i) Tax qualified</th>
<th>(ii) Non-tax qualified</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Company split</td>
<td>Non-taxable</td>
<td>Taxable transaction</td>
</tr>
<tr>
<td></td>
<td>Drop down type</td>
<td>transaction</td>
<td>(step up/down basis</td>
</tr>
<tr>
<td></td>
<td>Spin-off type</td>
<td>(carryover basis</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Contribution-in-kind</td>
<td>required)</td>
<td>required)</td>
</tr>
<tr>
<td></td>
<td>(though a capital</td>
<td></td>
<td>*Deferral of gain/</td>
</tr>
<tr>
<td></td>
<td>transaction in nature in fact</td>
<td></td>
<td>loss is required</td>
</tr>
<tr>
<td></td>
<td>as a reorganization method)</td>
<td></td>
<td>if group taxation</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>rules apply</td>
</tr>
</tbody>
</table>

(b) Transfer of shares (or shareholder)

<table>
<thead>
<tr>
<th>Share exchange (kabushiki kohan)</th>
<th>Non-taxable (carryover basis required)</th>
<th>Taxable transaction (step up/down basis required)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>*But deferral of gain/loss required if group taxation regime applies</td>
</tr>
</tbody>
</table>
[2] Reorganization methods not provided under the Japanese Corporate Tax Law

<table>
<thead>
<tr>
<th>Transfer of business</th>
<th>Asset acquisition (business transfer)</th>
<th>Taxable transaction (step up/down basis required)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer of shares (or shareholder)</td>
<td>Share acquisition</td>
<td>*Deferral of gain/loss required if the group taxation regime applies</td>
</tr>
</tbody>
</table>

A more detailed discussion of the taxation of corporate transactions in Japan within the above framework is set out below.

Reorganization methods provided under the Japanese Corporate Tax Law

The Japanese Corporate Tax Law provides rules for tax-free corporate reorganizations structured as a merger, company split, contribution-in-kind, share exchange (kabushiki kokan) and share transfer (kabushi iten). These rules do not extend to asset transfer or share transfer transactions.

There are three types of tax-free reorganization, and the following table lists the requirements for each type:

<table>
<thead>
<tr>
<th>Requirements for Tax-Free Reorganization</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type 1</strong></td>
</tr>
<tr>
<td><strong>Type 2</strong></td>
</tr>
<tr>
<td><strong>Type 3</strong></td>
</tr>
<tr>
<td>100% Group Reorganization</td>
</tr>
<tr>
<td>Group Reorganization</td>
</tr>
<tr>
<td>Joint Business Type Reorganization</td>
</tr>
<tr>
<td>Requirement 1</td>
</tr>
<tr>
<td>No Cash Transaction</td>
</tr>
<tr>
<td>No cash payment can be made.</td>
</tr>
<tr>
<td>Requirements for Tax-Free Reorganization</td>
</tr>
<tr>
<td>-----------------------------------------</td>
</tr>
<tr>
<td><strong>Type 1</strong></td>
</tr>
<tr>
<td>100% Group Reorganization</td>
</tr>
<tr>
<td><strong>Requirement 2</strong></td>
</tr>
<tr>
<td>Transfer of Employees</td>
</tr>
<tr>
<td>N/A</td>
</tr>
<tr>
<td>At least 80% of the employees involved in the divested business of the transferor corporation must be engaged in the business of the transferee corporation.</td>
</tr>
<tr>
<td><strong>Requirement 5</strong></td>
</tr>
<tr>
<td>Business Relatedness</td>
</tr>
<tr>
<td>N/A</td>
</tr>
<tr>
<td>The divested business and the business assumed (meaning any of the business in which the transferee corporation engages) must be related to each other.</td>
</tr>
</tbody>
</table>
### Requirements for Tax-Free Reorganization

<table>
<thead>
<tr>
<th>Type 1</th>
<th>Type 2</th>
<th>Type 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>100% Group Reorganization</td>
<td>Group Reorganization (more than 50% but less than 100%)</td>
<td>Joint Business Type Reorganization</td>
</tr>
</tbody>
</table>

**Requirement 6**  
Business Scale or Participation in Management

<table>
<thead>
<tr>
<th>Requirement 6</th>
<th>Type 1</th>
<th>Type 2</th>
<th>Type 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>The amount of sales, or the number of employees of the divested business or the business assumed, must not exceed a size of five times that of the other; or one of the specified officers of the transferor corporation (meaning a managing director or above or a person involved in management who is of equivalent rank) and one of the certain managing officers of the transferee corporation must be the managing officers of the transferee corporation after the reorganization.</td>
</tr>
</tbody>
</table>
### Requirements for Tax-Free Reorganization

<table>
<thead>
<tr>
<th>Type 1</th>
<th>Type 2</th>
<th>Type 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>100% Group Reorganization</strong></td>
<td><strong>Group Reorganization (more than 50% but less than 100%)</strong></td>
<td><strong>Joint Business Type Reorganization</strong></td>
</tr>
</tbody>
</table>

#### Requirement 7
**Continuity of Shareholding Relationship**

- **Type 1**: Continue group relationship.
- **Type 2**: Continue group relationship.
- **Type 3**: The shares held by shareholders who promise to continue to hold all shares delivered through the reorganization must represent at least 80% of the shares issued by the transferor corporation.
  
  *This does not apply if there are 50 or more shareholders.*

In a qualified reorganization, other than a share exchange (kabushiki kokan) or share transfer (kabushiki iten) transaction, the assets and liabilities must be transferred on a carryover basis (i.e., tax deferral is possible). In a qualified share exchange (kabushiki kokan) or share transfer (kabushiki iten) transaction, the assets owned by the acquired company would not be revalued.

- **In a non-qualified reorganization**, other than a share exchange (kabushiki kokan) or share transfer (kabushiki iten) transaction, the assets and liabilities must be transferred at fair market value. In a non-qualified share exchange (kabushiki kokan) or share transfer (kabushiki iten) transaction, the certain assets owned by the acquired company are required to be revaluated.
As mentioned above, even if the merger, corporate spinoff or contribution-in-kind is treated as a non-tax qualified reorganization, if the transaction is between the group companies such that if falls under the group taxation regime, recognition of any capital gain or loss from the transfer of certain assets will be deferred until the asset is disposed of, amortized, revaluated, written off or scrapped, or the domestic company is no longer wholly owned by another domestic company, foreign company or individual. In a non-qualified share exchange (kabushiki kokan) or share transfer (kabushi iten) transaction, the assets owned by the acquired company would not be revalued as long as the transaction is between group companies.

A merger is eligible for special tax treatment. The preservation of tax loss carryforwards can be possible if additional conditions are met.

The following table summarizes the key requirements and attributes for tax qualified reorganizations and non-tax qualified reorganizations:

### Mergers, Company Splits and Contributions-in-Kind

<table>
<thead>
<tr>
<th></th>
<th>Tax qualified</th>
<th>Non-tax qualified</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Transferor</td>
<td>Transferee</td>
</tr>
<tr>
<td><strong>Merger, corporate split and contribution-in-kind</strong></td>
<td>Non-taxable transaction (carryover basis is required)</td>
<td>Non-taxable transaction (carryover basis is required)</td>
</tr>
<tr>
<td></td>
<td>The transferor transfers the assets and liabilities at the book value.</td>
<td>The transferee recognizes the assets and liabilities at book value.</td>
</tr>
</tbody>
</table>

* In a merger, preservation of tax loss carryforwards is possible if additional conditions are met.
### Share Exchanges and Share Transfers

<table>
<thead>
<tr>
<th></th>
<th>Tax qualified including non-tax qualified between group companies</th>
<th>Non-tax qualified</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share exchange and share transfer</td>
<td>Non-taxable transaction - certain assets owned by the acquired company would not be revalued.</td>
<td>Taxable transaction - certain assets owned by the acquired company would be revalued.</td>
</tr>
</tbody>
</table>

### Transfer and Other Taxes

<table>
<thead>
<tr>
<th></th>
<th>Real property acquisition tax</th>
<th>Registration and license tax for land and buildings</th>
<th>Registration and license tax for</th>
<th>Consumption tax</th>
<th>Stamp duty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merger</td>
<td>N/A</td>
<td>Japanese registration and license tax is assessed on acquisitions of real property at the rate of 0.4% of the appraisal value based on a fixed assets tax.</td>
<td>The transfer of statutory intangibles, such as patent registrations and trademarks, is also subject to registration tax (JPY3,000 per patent and JPY3,000 per trademark, etc.).</td>
<td>N/A</td>
<td>A merger agreement is subject to stamp duty at a flat rate of JPY40,000 per one original.</td>
</tr>
<tr>
<td>Real property acquisition tax</td>
<td>Registration and license tax for land and buildings</td>
<td>Registration and license tax for</td>
<td>Consumption tax</td>
<td>Stamp duty</td>
<td></td>
</tr>
<tr>
<td>--------------------------------</td>
<td>---------------------------------------------------</td>
<td>--------------------------------</td>
<td>-----------------</td>
<td>------------</td>
<td></td>
</tr>
<tr>
<td><strong>Company split</strong></td>
<td>Real property acquisition tax is assessed on acquisitions of buildings at the rate of 3% (residential buildings) or 4% (other buildings) of the appraisal value based on a fixed assets tax and acquisitions of land at the rate of 3% of the appraisal value based on a fixed assets tax (or half of the appraisal value based on a fixed assets tax in the case of residential land). If certain conditions are met, the company split is not subject to real estate acquisition tax. Japanese registration and license tax is assessed on acquisitions of real property at the rate of 2% except for acquisitions of land which are assessed at the rate of 1.5% until 31 March 2013, and 2% on or after 1 April 2013 of the appraisal value based on a fixed assets tax. The transfer of statutory intangibles, such as patent registrations and trademarks, is also subject to registration tax (JPY15,000 per patent and JPY30,000 per trademark, etc.).</td>
<td>N/A</td>
<td>A company split agreement/plan is subject to stamp duty at a flat rate of JPY40,000 per one original.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Contribution-in-kind | Same as above. But, exemption treatment is not available. Same as above | Same as above | N/A | N/A |
A transfer of part of a company’s business will generally be structured as a business transfer or company split. The Japanese tax implications of a transaction involving a company split and a transaction involving an asset transfer can be summarized as follows:

<table>
<thead>
<tr>
<th>Company Split</th>
<th>Asset Transfer</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax qualified</strong></td>
<td><strong>Non-tax qualified</strong></td>
</tr>
<tr>
<td><strong>[1] Nature of transaction</strong></td>
<td>Cashless transaction</td>
</tr>
<tr>
<td><strong>[2] Capital gains tax</strong></td>
<td>No capital gains taxation occurs for the transferor. The qualified status is easily maintained in the case of a group reorganization.</td>
</tr>
<tr>
<td><strong>[3] Consumption tax</strong></td>
<td>No consumption tax applies</td>
</tr>
<tr>
<td></td>
<td>Company Split</td>
</tr>
<tr>
<td>---</td>
<td>---------------</td>
</tr>
<tr>
<td><strong>[4]</strong> Transfer of retirement reserve</td>
<td>Not a taxable event</td>
</tr>
<tr>
<td><strong>[5]</strong> Preservation of tax loss carryforwards</td>
<td>Not possible</td>
</tr>
<tr>
<td><strong>[6]</strong> Stamp duty</td>
<td>The company split agreement is subject to stamp duty at the flat rate of JPY40,000 per document.</td>
</tr>
<tr>
<td><strong>[7]</strong> Corporate Registration and License Tax</td>
<td>Applicable if the amount of capital is increased by x 1.5/1000 (the portion that exceeds the capital of the absorbed company is increased by x 7/1000), but if the capital is not increased by at least this amount, then a flat rate of JPY30,000 is applicable.</td>
</tr>
<tr>
<td><strong>[8]</strong> Registration and License tax for real estates</td>
<td>Reduced rate may be applicable.</td>
</tr>
<tr>
<td>Company Split</td>
<td>Asset Transfer</td>
</tr>
<tr>
<td>-----------------------------------</td>
<td>------------------------------</td>
</tr>
<tr>
<td><strong>[9] Registration and License tax for statutory intangibles</strong></td>
<td><strong>[9] Registration and License tax for statutory intangibles</strong></td>
</tr>
<tr>
<td>The transfer of statutory intangibles, such as patent registrations and trademarks, is also subject to registration tax (JPY15,000 per patent and JPY30,000 per trademark, etc.).</td>
<td>Same as left</td>
</tr>
<tr>
<td><strong>[10] Real estate acquisition tax</strong></td>
<td><strong>[10] Real estate acquisition tax</strong></td>
</tr>
<tr>
<td>If certain conditions are met, the company split is not subject to real estate acquisition tax.</td>
<td>Standard rate applies.</td>
</tr>
</tbody>
</table>

Reorganization methods not provided under the Japanese Corporate Tax Law

Asset Acquisitions

Basic Principles

An asset transfer is a taxable transaction for Japanese tax purposes. This type of transaction is also outside the scope of the qualified reorganization rules discussed below. Accordingly, asset transfer transactions usually cannot be structured as tax-free reorganizations.

Corporate Tax Implications at Transferor Level

Any gain from a sale of assets is taxable to the transferor under the Japanese Corporate Tax Law. Correspondingly, any built-in gain in the transferred assets must be recognized and will be subject to Japanese corporate tax at the effective tax rate of 42% (to be reduced to approximately 36% for fiscal years commencing on or after 1 April 2015) or 38% (for fiscal years commencing from 1 April 2012 to 31 March 2015) at the transferor level. If there is no built-in gain in the assets to be transferred generally, no negative income tax consequences should arise.

However, asset transaction between “group companies” (basically, domestic companies that are wholly owned by either a domestic company, foreign company or individual) are now subject to different treatment under a so-called “group
taxation regime” introduced in 2010. Under this group taxation regime, the recognition of a capital gain or loss from the transfer of certain assets between group companies is deferred until the asset is disposed of, amortized, revalued, written off or scrapped, or the domestic company is no longer wholly owned by another domestic company, foreign company or individual. These assets include fixed assets, land, securities and monetary receivables, etc. (excluding securities for trading purposes and assets with a book value of less than JPY10 million) Any gain or loss from an intra-group transfer is also deferred irrespective of whether the reorganization is a non-tax qualified or taxable transaction.

An asset transfer must be made at fair market value [see the Valuation Method section below]. The Japanese tax authorities will generally assume that a purchase price negotiated between unrelated parties should be categorized as fair market value but they will scrutinize related-party transactions. Related parties transferring business assets should ensure that there is documentation proving that they have employed standard valuation methods.

As a general rule, if the asset transfer amount is below fair market value, then the transferor is required to recognize the difference between fair market value and the consideration for the asset transfer as a non-deductible donation and the transferee is required to recognize the difference as a taxable gift gain. Conversely, if the asset transfer amount exceeds the fair market value, then the transferor is required to recognize the difference between fair market value and the consideration for the asset transfer as a taxable gift gain and the transferee is required to recognize the difference as a non-deductible donation. In short, the purchase and sale of assets at a price that is below fair market value gives rise to a risk of double taxation.

Intra-group asset transfers, however, are subject to special treatment, under group taxation rules introduced as part of 2010 tax legislation reform. This exceptional treatment applies to wholly owned group companies (but only those owned by companies). Under these rules, while the donation expense remains entirely non-deductible, the gift gain is entirely non-taxable. Consequently, no double taxation occurs. However, the parent company of the transferor and the transferee must adjust the book value (tax basis) of the shares.

The following table summarizes the tax consequences of an asset transfer at a price less than or greater than fair market value for entities that are subject to the group tax regime and entities that are not:
<table>
<thead>
<tr>
<th></th>
<th>Entities not subject to the group taxation regime</th>
<th>Entities subject to the group taxation regime</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transferor</strong></td>
<td><strong>Transferee</strong></td>
<td><strong>Transferor</strong></td>
</tr>
<tr>
<td>Asset transfer amounts &lt; fair market value</td>
<td>Non-deductible donation</td>
<td>Taxable gift gain</td>
</tr>
<tr>
<td>Asset transfer amounts &gt; fair market value</td>
<td>Taxable gift gain</td>
<td>Non-deductible donation</td>
</tr>
</tbody>
</table>

**Valuation Methods**

For Japanese tax purposes, the prevailing method for appraising the value of assets held by unlisted companies is net asset value including any goodwill as set out in the Japanese Assets Valuation Basic Circular.

The Japanese tax authorities will accept other valuation methodologies as long as the methodology is reasonable, objective and traceable. Supporting documentation demonstrating that the valuation is reasonable, objective and traceable should be prepared and kept in case of future tax audit.

**Corporate Tax Implications at Transferee Level**

The transferee will recognize the assets on a step-up basis (i.e., at their fair market value) regardless of the application of the group taxation regime. In addition, the transferee will be required to recognize goodwill (positive or negative), if any, being the difference between the fair market value of the net assets of the transferred business and the fair market value of the transferred business. The goodwill (positive or negative) must be amortized/accumulated over the subsequent five-year period on a straight-line basis. The transferee cannot recognize goodwill (positive or negative) unless the main assets and liabilities of the business unit are transferred to the transferee.

**Retirement Reserve**

The retirement reserve can be transferred only in the event of a non-tax qualified merger, non-tax qualified company split, non-tax qualified investment-in-kind or...
business transfer, and must meet the following conditions under the Japanese Corporate Tax Law:

- The amount of the retirement reserve being transferred must be assessed in light of generally accepted accounting principles and in accordance with a specified computation schedule.
- The transferee must recognize the employees’ service periods and performance, etc., during their employment with the transferor.
- The business transfer should be that of an identifiable/independent business unit in light of the definition of “business unit” under Article 467 of the Companies Act.
- The transferor must transfer the main assets and liability of the business unit to the transferee.

Material Future Liability

Under the Japanese Corporate Tax Law, if the transferee assumes any material future liability that will be paid within three years of the transaction, that material future liability can be transferred and recognized at the transferee level as a short-term material liability adjustment account. A short-term material liability adjustment account can be recognized only if the amount is more than 20% of the total amount of transferred assets.

Transfer and Other Taxes

Real property acquisition tax is assessed on acquisitions of buildings at the rate of 3% (residential buildings) or 4% (other buildings) of the appraisal value based on a fixed assets tax, and acquisitions of land at the rate of 3% of the appraisal value based on a fixed assets tax (or half of the appraisal value based on a fixed assets tax in the case of residential land).

Japanese registration and license tax is assessed on acquisitions of real property at the rate of 2% (except for acquisitions of land which are assessed at the rate of 1.5% until 31 March 31 2013, and 2% on or after 1 April 2013) of the appraisal value based on a fixed assets tax.

The transfer of ownership of any other registrable assets acquired from the transferor, such as registrable intellectual property, will also trigger the registration and license tax (e.g., JPY15,000 per patent and JPY30,000 per trademark).

Japanese stamp duty is assessed on agreements for the acquisition of business
assets, including real property, intellectual property rights, etc., that are prepared and executed in Japan.

Stamp duty rates are progressive and are assessed on the amount of the purchase price stated in the agreement. The maximum amount of stamp duty payable is JPY600,000 on an agreement involving a purchase price of more than JPY5 billion.

**Tax Disadvantages of an Asset Transfer**

In general, tax loss carryforwards held by the transferor cannot be transferred to the transferee of the business assets. This general prohibition on the transfer of net losses constitutes an important tax disadvantage for the asset transfer. In addition, consumption tax (similar to VAT) will be imposed at a 5% rate on the transfer of taxable assets (such as inventories and fixed assets, both tangible and intangible assets).

**Share Acquisitions**

Where the target corporation issues new shares to the purchaser, there will be no gain to the target corporation since the funds received are considered a contribution to capital (or alternatively the transaction is characterized as a kind of capital transaction that is neutral for Japanese corporate tax purposes). However, if the purchaser subscribes to newly issued shares at a "particularly favorable price," at a discount of 10% or more of the market price, the discount will constitute a taxable gift gain to the purchaser. This rule applies even if the purchaser has a taxable presence in Japan. However, gift income may be exempt from Japanese tax under the operation of some double tax treaties.

Gains on sales of existing shares will be taxable to the transferor under the Japanese Corporate Tax Law. However, if the transferor is a non-resident, capital gains from the sale of such shares may be exempt from Japanese tax under some double tax treaties. The anti-avoidance rules described above in relation to assets generally also apply to share acquisitions.

Tax on a capital gains realized from a share exchange (kabushiki kokan) or share transfer (kabushi iten) transaction not involving any cash is deferred until the shares are sold.

**Valuation Methods**

Where the price of the shares exceeds their net asset value, the excess can be attributed to a control premium. In some cases, the acquisition of a control
premium is recognized for Japanese tax purposes and not treated as a donation. However, restrictions apply to subsequent downward adjustments of the control premium portion.

Please refer to the Valuation Methods section in relation to asset transfers above for general valuation principles.

Transfer and Other Taxes

Registration and license tax is assessed on new share issues at the rate of 0.7% of the subscription price. The minimum amount of tax payable is JPY30,000.

Share purchase agreements are not subject to stamp duty and, as noted above, acquisitions of shares are not subject to Japanese consumption tax.
**Share Acquisitions**

An acquisition of the shares of a corporate employer will not affect its obligations to its employees because the employing entity will remain the same.

In practice, however, the purchaser may need to change the working conditions of the employees if the target is moved from one company group to another and the purchaser wishes to integrate the target’s working conditions with the working conditions of the other group companies. If the adjustment of the working conditions involves any changes that are disadvantageous to the transferred employees and these changes cannot be reasonably justified, the employees must individually consent to the changed working conditions. In general, whether or not their consent is required will depend on the degree of disadvantage involved. A 10-minute extension of the working day might not require consent, but a reduction of salary or benefits almost certainly would.

**Asset Acquisitions**

Under the Japanese Civil Code, when a business is sold, the vendor must obtain the consent of any employee that the purchaser proposes to employ. Employees whom the purchaser proposes not to employ remain employees of the vendor. The asset acquisition does not give the vendor a justifiable reason to terminate the employment of employees who are not offered employment by the purchaser. If the vendor wishes to no longer employ such employees, then the vendor must follow the regular termination procedures under Japanese labor laws, including
offering voluntary retirement packages to solicit the voluntary resignation of these employees. The unilateral termination of the employment contract by the vendor should be a last resort.

If the vendor needs to unilaterally dismiss any employees due to the business transfer, it must ensure that such dismissals are carried out in accordance with the requirements under Japanese labor laws and any related principles. Under the Labour Contract Act and relevant court precedents, the “abuse of rights” doctrine places strict limits on the rights of employers to terminate employment contracts and unless these limits are carefully addressed, employees may be able to seek reinstatement and/or damages for unlawful dismissal.

A transfer of an employee to the purchaser can be effected by either:

- a termination by the vendor and rehire by the purchaser; or
- a transfer of the employment contract from the vendor to the purchaser.

In general, the termination and rehire process is used more frequently where the employees are transferred to a company outside the purchaser’s current group of companies. The transfer of contract process is more frequently used where the employees are transferred within group companies.

Both methods require the consent and cooperation of the transferring employees. The vendor and the purchaser need to carefully compare the original working conditions of the employees with those to be offered by the purchaser and analyze whether individual consents are required to be obtained. To obtain consent from all of the target employees as smoothly as possible, it is recommended that the new working conditions to be offered to the employees be no less favorable than their existing conditions.

**Termination and Rehire**

In the case of the termination and rehiring of employees, a transferring employee is entitled to the payment of any accrued retirement benefits upon the transfer. In many cases, employees prefer to have accrued retirement benefits and other entitlements (e.g., pension benefits) transferred to the purchaser rather than to have them paid out on the transfer but this is not always the case. Where the employees’ accrued entitlements are transferred to the purchaser, there will be a corresponding reduction in the purchase price of the business. However, since there are several types of entitlement arrangements, which vary from company to company, it is sometimes not possible for the transferring entity to transfer
employees’ accrued pension benefits to the receiving entity. If this is the case, it is necessary to pay out the pension benefits of these employees. Therefore, it is critical for the parties to determine:

- the nature of the pension benefit arrangements adopted by both parties; and
- whether they are compatible or not during the due diligence process.

Transfer of Employment Contract

In the case of a transfer of employment contract, the employment contract between the vendor and the employee will be transferred to the purchaser. In principle, the employment conditions of the employee remain unchanged after the transfer, and the accrued retirement benefits and other entitlements will also be transferred to the purchaser. In practice, however, it may be difficult for the purchaser to have the transferred employees and the existing employees on different working conditions. Therefore, an adjustment of the working conditions after the transfer is usually required. If the adjustment of the working conditions involves any changes that are disadvantageous to the transferred employees, they must individually consent to the changed working conditions in the manner discussed above.

Mergers

In a merger situation, the employees of the target company become employees of the merged entity as of the merger date by operation of law. There is no requirement for either the acquirer or the target to obtain the consent of their respective employees to the merger itself.

However, where there is a significant difference between the employment conditions of the acquirer and the target company, and the acquirer proposes to adopt conditions less favorable to either its own employees or the employees of the target, the consent of the employees so disadvantaged may be required in the manner discussed above.

Company Splits

If certain procedures under the Labour Contracts Transfer Act are followed, employees substantially engaged in the business that will be transferred as part of the company split (target business) may be compelled to transfer to the acquiring entity. In other words, a vendor in a corporate spinoff may not be required to obtain the consent of employees who are substantially engaged in work for the target business. However, the vendor, as employer, is still
obliged to use its best efforts to obtain the employees’ informal consent and cooperation with regard to the transfer and prior consultation with the employee representative and transferring employees is compulsory. This is especially so if the shareholder of the spun-off entity is expected to change immediately after the spinoff. In these circumstances, it is critical for the employer to disclose the spinoff plan and obtain the target employees’ informal consent to the proposed ownership change.

The Supreme Court has recently held that a failure to consult with the target employees may invalidate the transfer of the employees under the company split if:

- consultations are not held at all; or
- the consultations or communications undertaken by the vendor are insufficient and clearly do not satisfy the purpose of the consultation requirement.

The Tokyo High Court decision appears to narrowly limit the situations in which the transfer of employees through company splits can be invalidated due to a failure to collectively consult with the employees in good faith.

Separately from the consultation obligation, the spun-off entity must also take into account the individual objection process. The Labour Contracts Transfer Act provides exceptions to an automatic transfer in certain specific cases, thereby allowing employees to individually object to the company’s decision. Employees who are not primarily involved in the transferring business can object to the transfer if the company decides to transfer them. On the other hand, employees who are primarily involved in the transferring business can object to a decision of the company not to transfer them. The rules concerning which employees have the right of individual objection are quite detailed and beyond the scope of this guide.

**Consultation with the Union**

Where a target company’s employees are unionized and a collective bargaining agreement has been concluded between the union and the vendor, such agreements occasionally require that the vendor:

- notify the union;
- engage in advance consultations with the union; and/or
- obtain the union’s consent in relation to the proposed acquisition transaction (including any of the types of transactions listed above).
Even if the collective bargaining agreement does not specify such a provision, it is recommended in the interest of maintaining a good relationship with the union that such prior notification or consultation with the union be conducted. As discussed above, individual consents from the employees are required in certain circumstances. A negative reaction from a union makes it difficult to obtain such consents from individual employees.

In light of the above, when scheduling a transaction, sufficient time for consulting with the union should be factored in into the timeline.

**Pensions**

Some companies have private pension plans in addition to, or instead of, government welfare pension insurance. In any M&A transaction, complicated issues surround any applicable private pension plan. In broad terms, there are two main scenarios:

- The extension of the pension system to the transferred employees
- Providing a cash-out of the pension fund to the transferred employees

In the first scenario, it is necessary to check whether this option is indeed possible. A private pension scheme shared among group companies usually cannot be extended to employees moving outside of the group.

In the second scenario, it is necessary to consider how to compensate the employees for future pension benefits.

Regardless of what type of M&A structure is used, if the employees’ working conditions, including their pension plans are changed to their detriment, consent from the employees and possibly also the union will be required. If the pension plan is discontinued, or is changed to a less favorable pension plan, the acquiring company will need to consider how to compensate the employee for any such disadvantageous impact on the employee’s pension plan to obtain the necessary consents from the employees in a smooth manner.

The transfer of pension funds or arranging for the pension funds to be cashed out to employees usually requires actuarial calculations and is very time consuming. Accordingly, the timeframe required for these aspects should be taken into consideration in scheduling an acquisition transaction. Further, in many cases, a defined benefit (or cash balance) pension plan has unfunded portions. To cash out such a pension, this unfunded portion must be considered. The allocation of these pension liabilities between the vendor and the purchaser is often a contentious issue during negotiations.
Health Insurance Associations

A health insurance association ("HIA") is a private association authorized by the government to provide health insurance in the place of government health insurance. An HIA can be established by a single company or a group of companies if certain thresholds are met and government authorization is obtained. An HIA provides, not only an insurance package that corresponds to government health insurance, but also provides some additional insurance coverage. In general, an HIA usually has better coverage than government health insurance.

When acquiring a company or business covered by an HIA, the acquirer must consider:

- whether it is possible to continue the HIA coverage; and if not,
- how employees can be compensated for the discontinuation of the HIA coverage.

If the HIA needs to be newly created or replicated to extend the coverage to transferring employees, the government authorization process is time consuming and must be taken into consideration when scheduling the transaction.

Social Insurance

Where employees are transferred together with business assets, the vendor must file a termination notice and the purchaser must file a corresponding employment notice with the relevant social insurance and unemployment insurance offices. Based on these notices, the obligation to pay insurance premiums will transfer from the vendor to the purchaser.

Protection of Employee’s Privacy

Personal data, including personal data of employees is protected under the Act on the Protection of Personal Information ("PI Act"). Under the Third Party Disclosure Restriction Principle of the PI Act, personal information may not be disclosed or made available to third parties without the prior consent of the data subject (in other words, the Japanese system is an opt-in system) unless one of the following specific exemptions apply:

- The disclosure is made in accordance with law.
- The disclosure is necessary to protect life, limb or property (i.e., sudden illness).
• The disclosure is necessary to protect public health (i.e., an epidemiological investigation).

• The disclosure is necessary for governmental purposes (i.e., tax investigations).

In a transaction involving an employee transfer, the issue of how the vendor may disclose personal information concerning a transferring employee to the purchaser will arise. However, there is a general exemption to the third-party disclosure restrictions that is applicable in this context known as the “disclosure due to corporate merger, etc.” exemption. The reference to “corporate merger, etc.” is generally considered to include not only mergers but also other types of acquisitions, such as share acquisitions, asset acquisitions and corporate spinoff transactions.

Accordingly, this exemption permits information to be disclosed to a surviving or newly established company as a result of a merger, and also to a purchaser of a business. This exemption is only applicable when the transaction is completed. Therefore, the parties cannot rely on this exemption during the process of due diligence. Prior to the completion of any transaction, an employer should mask employees’ names and any other relevant information that would enable the party conducting due diligence to identify individual employees.
Language and Style

Language is a major issue in cross-border transactions with Japanese parties, particularly inbound transactions. English language documentation is used in most cases. However, if bilingual documentation or a Japanese or English translation is prepared, the controlling language for the transaction documentation will be a threshold issue. If a translation is required, it is important to factor in the time required for translation into the transaction timeline.

Governing law is also an important consideration here. If the governing law is Japanese law and an English-language agreement is used, it will be necessary to review the document to ensure that any terms that have no settled meaning in Japanese law are properly defined in the document or replaced with corresponding Japanese terms.

In regard to style, the Japanese party will generally prefer a shorter document. Governing law may also have an impact with respect to style. For example, an American-style document may be considered more appropriate if the governing law is US law. If the governing law is Japanese law, the Japanese party may argue that a shorter Japanese-style document is more appropriate.
Preliminary Agreement - Memorandum of Understanding/ Letter of Intent

Japan follows generally accepted international practices in the negotiation and documentation of cross-border acquisitions. Ordinarily, negotiated acquisitions begin with, or include, a letter of intent or memorandum of understanding. A letter of intent often provides a useful outline of the transaction and may also serve to prevent the vendor from negotiating with other parties (a “no-shop” or “standstill” agreement). It may enable the governmental approval process to begin and also facilitate financing for the transaction.

Furthermore, a letter of intent can be very useful in defining a purchaser’s inspection and due diligence rights, providing for the treatment of confidential and proprietary information and establishing a schedule for completing all matters necessary to close the transaction.

The letter of intent may be expressed to be binding or non-binding, wholly or in part. Unless drafted carefully, a court may decide that the document is binding even if it states that it is meant to be non-binding. Japanese courts are not bound by any parol (verbal) evidence rules in the construction of contracts and may consider any evidence of oral statements and representations that override or conflict with the terms of the written agreement.

Due Diligence

In the context of cross-border M&A, it is generally accepted that the purchaser will seek maximum disclosure of information as early as possible before or in the course of negotiations regarding the terms and conditions of the sale.

Legal Issues

In share acquisitions involving shares in listed companies, insider trading laws are relevant. A potential purchaser, its directors and officers and certain other related parties are strictly prohibited from purchasing or selling shares in the target company whether on- or off-market before any material non-public price sensitive information (so-called material information) of the target company that might have come into the possession of the potential purchaser during the course of the negotiations or otherwise becomes publicly available.
Public Searches

Searches of publicly maintained corporate, real property and intellectual property registers are standard due diligence procedure in Japan. More problematic, however, are searches of corporate security interests. While there are registration systems with respect to a limited range of specific security interests, there is no central repository of documents or information which enables identification of the existence of all liens or security interests with respect to a corporation simply by searching under a particular corporation’s name. Accordingly, in share acquisitions, properly scoped requests for information and a thorough review of information provided by the vendor is important.

Comprehensive litigation searches are also practically impossible because there is no central register of proceedings. Court registers can only be searched on a local basis. Some district courts have facilities that enable a public search of pending proceedings. Unless the court designates otherwise, case documents are generally open for public inspection but only the parties to the proceedings and other certain related parties approved by the court can take photocopies. Due to the limited scope of litigation searches in Japan, the purchaser must usually rely on information provided by the vendor in this regard.

Process

The due diligence process will usually begin with the purchaser and its advisors deciding the nature and scope of the due diligence investigations by drawing up a due diligence checklist that identifies the matters to be investigated. Depending on the scale of the transaction, it may be necessary to set materiality thresholds as part of this process. Usually, these thresholds will be set in monetary terms, e.g., contracts valued at JPY1 million or more are to be considered material and therefore worthy of review.

In large transactions, the vendor will often make information about the business available for a limited period in a data room. In smaller transactions, the vendor will usually forward copies of materials requested by the purchaser to the purchaser’s advisors. In either case, the vendor must be careful to avoid conduct that may be subsequently relied upon by the purchaser to terminate the agreement. Virtual data rooms are now commonplace in cross-border transactions but physical data rooms are more prevalent in domestic transactions.
Lawyers are usually responsible for conducting a legal review of the target company’s business affairs, while accounting firms will be asked to conduct a review of the target’s financial and accounting records. It may also be necessary to engage valuers to assess the value of particular assets (e.g., real estate).

The reporting process and depth of information provided to the purchaser will vary depending on its information needs. The purchaser may want a report of its advisors’ preliminary findings. If it is well briefed on the target company during the course of investigations, it may only want a report on the principal risk areas. Alternatively, it may want a detailed report on all the materials and information provided by the vendor.

**Acquisition Agreement**

An acquisition agreement may be signed after completion of the due diligence process or may be made conditional on satisfactory completion of due diligence investigations.

Where regulatory or other consents or approvals have to be obtained, or the purchaser wishes to conduct further due diligence after the signing of the agreement, completion of the transaction will be delayed until those processes have been satisfactorily completed. The agreement must be carefully drafted to ensure that:

- responsibility for fulfilling such conditions is clearly assigned to the relevant party;
- the business is properly managed in the period between signing and completion; and
- the risk of adverse changes in the business is properly apportioned.

**Representations and Warranties**

From the purchaser’s point of view, the aim of due diligence is, of course, to ensure that there are no unexpected liabilities and that the business and assets of the target company are in the condition represented. The purchaser generally wants to be in possession of sufficient information to be able to properly price the shares or assets that it proposes to acquire.
However, in most cases a purchaser will want to supplement the information it obtains in the due diligence process with contractual representations and warranties given by the vendor. In a sense, the provision of warranties shifts the due diligence burden onto the vendor. It is in the interest of the vendor to verify a warranty before contractually committing to its truth.

It is axiomatic that the larger the transaction, the more detailed and comprehensive the warranties sought by the purchaser. The scope of vendor warranties will also vary depending on the transaction. Core issues covered by warranties will include the target company’s accounts, corporate organization, taxation, title to assets, intellectual property rights, plant and equipment, insurance, employment, environmental matters and litigation.

The vendor will usually seek to limit its warranty obligations through materiality, knowledge and other limitations. The vendor will want to set minimum and maximum limits on the amounts that the purchaser can recover for breach of warranty. In Japan, warranties are generally subject to a 10-year statutory limitation period under the Civil Code.

Representations and warranties are, however, no substitute for thorough due diligence. There are practical limits as well as contractual limits: the purchaser must establish breach of warranty and proof of loss; the vendor may not be in a position to meet its obligations under the warranties if sued; and litigation may be time-consuming and costly.

Closing

In a share acquisition involving a private company which issues share certificates, transfer of title to the shares takes place by the delivery of share certificates to the purchaser. If the target company does not issue share certificates, transfer of title to shares takes place by agreement between the transferor and the transferee (a private company has the option not to issue share certificates under the Companies Act). The transfer must be registered in the target company’s shareholders’ register in order for the transferee to be able to assert its rights as a shareholder against the company. The vendor will usually be obliged to deliver signed resignations of its appointees and may also be required to hold a shareholders’ meeting to appoint the vendor’s nominees just prior to or on closing (see also the discussion below regarding Public Company Considerations, Share Transfers).
In an asset acquisition, the transfer of title to the assets may not occur until after the closing. Much will depend on the type of asset being acquired and what is required in order to effect a transfer. The vendor will be obliged to obtain the consent of any employees to be transferred to the purchaser. In many cases, the vendor and the employees will expect the purchaser to provide the same employment conditions that existed prior to the sale.
Share Transfers

Japan abolished share certificates and adopted a book entry system for transfers of shares in public companies in 2009, when The Act Concerning Book-Entry Transfer of Bonds, Shares, Etc. ("Book-Entry Transfer Act") was enacted.

Under the current system, shareholders are required to open their own accounts for the book-entry transfer of shares at account management institutions such as financial instruments and exchange firms, or commercial banks and trust banks, which have, directly or through other account management institutions, opened accounts in the Japan Securities Depository Centre, Inc. ("JASDEC"). All rights attached to the listed shares with respect to the transfer, creation of pledges and issuance of shares shall be determined based on the description or record in the ledgers of the book-entry transfer accounts. The transfer of listed shares will become effective when the transfer is recorded in the book-entry transfer account of the transferee.
Acquisition of a Substantial Shareholding

The 5% Rule

A person who has acquired shares in a public company listed on a stock exchange and whose holding ratio in respect of the issued shares in the company (being shares carrying voting rights) has increased to over 5% must file a substantial shareholding report with the relevant local finance bureau within five business days after the acquisition. A copy of the report must also be given to the public company.

Under the 5% rule, all reporting parties, including individuals, are now required to file a substantial shareholding report by using the electronic disclosure system known as the Electronic Disclosure for Investor’s Network ("EDINET"). In order for a person to be entitled to use the EDINET system, an application form needs to be submitted to the local finance bureau in advance to receive an assigned ID number and pass code (in the case of a foreign corporation, a Japanese translation of the articles of incorporation must also be submitted as an attachment).

A substantial shareholder must also report changes to its shareholding of 1% or more, and material changes to information previously reported. The obligation to report ceases if a substantial shareholder reports that its shareholding is not more than 5% of the public company’s issued shares. There is no rule that requires a shareholder to stop acquiring a public company’s shares when it reaches a reporting threshold.

The 5% rule applies only to acquisitions of voting shares. Acquisitions of equity-related securities such as convertible bonds (technically called bonds with stock acquisition rights), warrants (stock acquisition rights) and class shares (convertible shares) will be subject to the 5% rule if the underlying shares carry voting rights. The 5% rule also applies to options, exchangeable bonds and depository receipts.

The 5% rule refers to persons who “hold” rather than “own” shares and may also apply not only to acquiring rights of ownership to shares but also to acquiring the rights to investment in shares on behalf of clients based on a securities discretionary investment agreement or the rights to exercise voting rights or give instructions regarding the exercise of voting rights based on laws or contracts such as trust agreements.
The 5% rule also applies to cooperative holders that jointly hold more than 5% of a public company’s shares. A cooperative holder includes a shareholder who agrees to jointly purchase or transfer its shares or exercise its voting rights, or who has a capital or marital relationship with one or more other shareholders. Cooperative holders must each or jointly file a substantial shareholding report.

Insider Trading

Under the FIEA, a person (called an “insider”) commits the offense of insider trading if that person buys or sells the shares of a public company, being aware of material information relating to the company’s business through “specified means,” before such information is made publicly available by the issuer company (i.e., through a public announcement by the issuer company) (see box: Defining Insiders and Insider Trading). This is also the case with the persons (called primary information recipients) who receive material information from an insider before the information becomes publicly available.

The prohibition on insider trading does not apply to off-market transactions between insiders, provided that both the seller and the purchaser are not aware that the purchaser will subsequently sell the acquired shares on- or off-market in violation of the insider trading rules. This exemption will apply, for example, where a purchaser that comes into possession of material information through a due diligence review of the target company purchases shares from a seller that is also an insider. However, if the deal breaks, the potential purchaser that came to possess material information in the course of the due diligence is strictly prohibited from dealing with the shares of the target company before the information becomes publicly available.

An insider who commits the offense of insider trading may be subject to an administrative fine calculated based on the price, etc. of the shares (“kacho-kin”), as well as to a criminal penalty. The FSA has recently more vigorously prosecuted violations of the insider trading rules relating to the takeover bid (“TOB”) process, and the number of cases resulting in an administrative fine being imposed in relation to a TOB has increased.
Defining Insiders and Insider Trading

The FIEA deems certain persons to be insiders for purposes of the prohibition of insider trading. These persons include the company’s directors, officers, 3% shareholders, employees and agents, persons with legal authority or power over the company, and persons negotiating or contracting with the company.

“Specified means” include situations where:

- the performance of any employee or agent of the company becomes aware of the information through their duties;
- a 3% shareholder becomes aware of the material information through the exercise of its shareholder rights to investigate accounting books;
- any person becomes aware of material information through authority over the company granted pursuant to laws and regulations;
- any person becomes aware of material information in connection with negotiation of or performance of duties under a contract which they have entered into or are negotiating with the company; and
- certain officers become aware of material information through the performance of his or her duties.

The FIEA also deems certain events and circumstances to be “material Information.” These include company decisions regarding important issues such as capital raisings, mergers and acquisitions, and dividend formulae. Adverse business developments, changes to major shareholders and material changes in sales and earnings projections also constitute material information. The FIEA has a catch-all provision that includes all information that may not be specifically provided for in the FIEA provisions but that may, nonetheless, have an important bearing on the company’s management, business opportunities and property, and that may have a decisive impact on a decision to buy or sell the company’s shares. Information falling within this catch-all provision may also constitute material information.

Takeovers Code

A person seeking to acquire more than a certain amount of the voting shares of a listed company off-market in a certain way is required by the TOB regulations to make a TOB or tender offer to all shareholders.
Prior to 2000, the vast majority of TOBs in Japan were prearranged between the buyer and the seller. Prearranged bids are necessary because of the requirement to make a TOB to all shareholders. Few TOBs were used as true acquisition vehicles in Japan. Most of the TOBs in Japan were used as a stock repurchase by a listed company to adjust the market price of the company’s share. After 2000, the number of TOBs in Japan increased and the TOB process became a more widely accepted acquisition tool.

**TOB Process**

The takeover regulations govern off-market acquisitions of shares in listed companies. On-market purchases are exempt from the TOB process. However, under amendments to the regulations effective in July 2005, cross-trading on after-hours systems such as the Tokyo Stock Exchange’s (“TSE”) Trading Network System (“ToSTNet”) is no longer exempt from the takeover rules. This amendment was introduced after a hostile takeover play in which the purchaser acquired a 38% stake in the target’s parent company by way of a series of cross-trades on ToSTNet. Up until that point, cross-trade purchases were regarded as on-market transactions exempt from the TOB process. At the same time, however, almost all TOBs had been “friendly” in the sense that the offeror had negotiated the terms of the acquisition with key stakeholders including the principal shareholder and the board of directors before launching a formal bid.

Additionally, amendments enacted in December 2006 prohibit on-market purchases, other than by way of tender offer, from following a certain off-market purchase or cross-trading on the after-hours systems referred to as “rapid acquisitions” (refer to section on Prohibited Transactions - “Rapid Acquisitions” below).

The TOB process (see box: The TOB Process) is a statutory requirement under the FIEA that must be complied with in order to complete the transaction.

**The TOB Process**

Broadly, the principal steps and features of the TOB process are as follows:

- The offeror must publish a notice (a commencement notice) announcing the TOB in at least two daily newspapers; in a nationwide newspaper or through EDINET with a notice in a nationwide newspaper.
The TOB Process

- The offeror must, on the same day that it publishes the commencement notice, file with the applicable local finance bureau a TOB registration statement containing prescribed information regarding the TOB and forward copies of the TOB registration statement to the target company, and to any other person who has filed a competing TOB registration statement. The amended TOB regulations expanded the scope of information to be included in the TOB registration statement.

- The offeror must deliver a document called a TOB prospectus to those shareholders of the target company.

- The offer price must be the same for all shareholders (if the offers are cash offers).

- The offer may be subject to a minimum acceptance condition. However, if the condition is satisfied, the offeror will be bound to purchase at least the number of shares specified in the offer.

- The offeror may put a cap on the number of the shares to be purchased during the TOB period. If the total number of shares tendered exceeds the cap, the number of the shares purchased from each shareholder responding to the offer is then determined on a pro-rata basis. However, if the offeror tries to purchase two-thirds or more of the existing voting rights through the tender offer, then the offeror will not be able to put any cap on the number of shares to be purchased and will be obliged to purchase all of the offered shares.

- The offer period must be set between a minimum of 20 business days and a maximum of 60 business days from the day after the date of the commencement notice. If the offer period is set at less than 30 business days and certain other conditions are met, the target company will have the right to extend the offer period by up to 30 business days.

- An offeree may withdraw its acceptance of the offer at any time during the period for which the offer is open but the offeror may not abandon the TOB process once it is commenced unless certain conditions that are required by the FIEA and set out in the TOB registration statement are satisfied (e.g., the offeror can abandon the TOB process in the case where the target exercises a poison pill after the TOB commences).
The TOB Process

- The offeror must publish in daily newspapers or publicly announce the results of the TOB and file a report of the results of the TOB with the competent Local Finance Bureau.
- The offeror must transfer the shares sold to it and pay the purchase price without delay after the offer period closes.

TOB Agent

It is mandatory for the offeror to appoint a securities company or bank as a stock handling agent to record the purchase of the shares in the book-entry transfer account of the offeror and to arrange for the payment of the purchase price to the offeree.

A non-resident is required to appoint a resident agent for the purpose of filing documents such as the TOB registration statement.

Reply by Target Company

The target company is obliged to file a statement regarding the TOB offer (target statement) with an applicable local finance bureau within 10 business days from the date of the commencement notice (as provided in the relevant ministerial decree). If a target statement sets out certain questions to the offeror, then the offeror will be required to file an answer statement with the applicable local finance bureau.

Fairness Opinions

The TOB regulations require the offeror to describe detailed grounds for the purchase price and the process to determine the purchase price in the TOB registration statement. If the offeror obtains a third party opinion (whether in the form of a formal “fairness opinion,” “valuation letter” or otherwise) with respect to the valuation of the shares in the target company when determining the purchase price, the TOB registration statement will need to specify the identity of such third party and also provide a summary of the opinion and the process used to determine the purchase price. However, the law does not require the offeror to obtain a third party opinion at the commencement of the TOB.
The TOB regulations also do not require the target company’s board of directors to obtain a fairness opinion or any other opinion by a third party. However, it has recently become an established practice in Japan for the board of a target company to obtain a third party opinion regarding the valuation of the shares in the target company in order to satisfy their fiduciary duties to the shareholders of the company.

**Mandatory Offer Obligation**

The TOB procedure is mainly triggered when:

- the acquisition of more than a 5% holding of a listed company’s stock by an off-market purchase, except for an acquisition from 10 shareholders or less within a period of 61 days; or

- the acquisition of more than one-third of a listed company’s stock by an off-market purchase or cross-trading on an after-hours system. If this is the case, the TOB process will be required even if the stock is acquired from 10 shareholders or less within a period of 61 days.

The TOB regulations enacted in December 2006 introduced the counter-TOB rule. If a person makes a tender offer in relation to a listed company and a major shareholder of that target company, holding more than one-third of the target company’s stock, commences to purchase more than 5% of the company’s stock during the offer period of the existing tender offer, the purchase by the major shareholder will be required to follow the TOB procedures.

**Prohibited Transactions - “Rapid Acquisitions”**

The December 2006 reforms also prohibited certain “rapid acquisitions” of a listed company’s stock by using a combination of on- and off-market purchases. The acquisition of a listed company’s stock will be illegal under the FIEA, if:

- an acquirer acquires more than 10% of the voting rights of a target company by any means (including on- or off-market purchases, TOBs and acquisitions of new shares) within three months;

- these shares, which the acquirer has acquired within three months, include more than 5% of the voting rights acquired by off-market purchases or cross-trading on an after-hours system; and

- the acquirer holds more than one-third of the voting rights.
This restriction tries to prevent any evasion of the TOB regulations by way of a combination of on-market and off-market trading to acquire more than one-third of the voting rights of a target.

Announcements

As noted above, the offeror must publicly announce the terms of the TOB on the day when making formal offers to shareholders and it must also publicly announce the results of the TOB on closing. Appendix B sets out a sample timetable for the TOB process.

Acquisitions and Disposals by Listed Companies

Where the vendor, purchaser or target is a listed company, the FIEA and stock exchange listing rules may require disclosure of the transaction.

General Disclosure Obligations

The TSE Listing Rules and rules of other relevant exchanges, such as JASDAQ, require a company listed on the relevant exchange to notify the exchange immediately of any material corporate information. The exchange rules define material corporate information as information that “significantly affects investor decisions” (i.e., price-sensitive information).

Specific Disclosure Obligations

There are potentially two sources of specific disclosure obligations: the FIEA and the listing rules of stock exchanges.

Securities Law Obligations

Under the FIEA, all public companies are required to file a report (an extraordinary report) with the relevant local finance bureau immediately upon the occurrence of certain specific events, including:

- corporate decisions regarding mergers, share exchanges, share transfers, company splits or business transfers;
- changes in principal shareholders (i.e., a shareholder who has 10% or more voting rights);
- changes in parent company or designated subsidiaries;
• certain matters relating to consolidated subsidiaries; and
• events significantly impacting on the company’s financial condition or operating results.

Listing Rules

A company listed on a stock exchange is also required to immediately disclose to the exchange information specified in the timely disclosure rules of the exchange (for an example of disclosure requirements under a stock exchange’s timely disclosure rules, see box: Disclosure Requirements Under the TSE Listing Rules).

### Disclosure Requirements Under the TSE Listing Rules

The TSE listing rules require immediate disclosure in some cases.

- **Matters concerning the listed company**
- Corporate decisions regarding a range of transactions, including:
  - stock and share acquisition rights issues;
  - capital reductions;
  - stock splits and consolidations;
  - mergers, share exchanges, share transfers, company splits and business transfers;
  - sale and purchase of downstream entities;
  - senior management changes;
  - new product and technology developments;
  - formation and dissolution of strategic alliances;
  - business start-ups; and
  - significant employee reductions.
- Certain events including:
  - change in major shareholders; and
  - change in parent company or other affiliated company.
Disclosure Requirements Under the TSE Listing Rules

Matters concerning financial information including:
- amendment to financial results forecast; and
- amendment to expected dividends.
- Matters concerning its subsidiaries
- Matters concerning its parent company, which is not a listed company.

Types of Transaction

A takeover of a listed company would ordinarily proceed in one of the following ways:
- An off-market acquisition through a TOB
- The listed company issues shares to the acquirer, with shareholder approval [when the price is especially favorable] under the Companies Act, giving that person a controlling stake
- An on-market acquisition of the target’s shares (Please refer to Share Acquisitions of Listed Companies above for other possible types of acquisitions); this process is restricted as a rapid acquisition if certain conditions are met.

Disclosure and Approval Requirements

Please refer to Acquisitions and Disposals by Listed Companies (discussed above) for a brief summary of the disclosure requirements that apply under the listing rules of the relevant exchange and the FIEA.

As explained above, an acquisition or disposal of “important property” requires board approval. Disposal of all or a substantial part of the assets of a company which constitutes a business transfer must be approved by way of a special shareholders’ resolution. Acquisition of all the assets of company as a business transfer must be approved by way of a special shareholders’ resolution.
Connected Transactions

The purchase or sale by a listed company of an asset (including shares) from or to an associated company is not subject to any special requirements under Japanese law. However, such a transaction may require the approval of the board of the vendor or purchaser if the asset is “important property” (see Companies Act Requirements above).

Stock Exchange Listing Rules

A company listed on a stock exchange such as the TSE is required to disclose material corporate information without delay as timely disclosure.

If the stock exchange becomes aware of any material corporate information concerning a company listed on the exchange through the media, a rumor or through communications with an outside source, the exchange will then ask the company for an explanation. The company must respond by denying the information, clarifying the information or disclosing the information.

In addition, the exchanges have delisting rules. For instance, the TSE Listing Rules, which were amended in November 2007, provide that a listed company shall be delisted if the total aggregate number of the shares held by shareholders who hold 10% or more shares and the listed company’s officers and the company’s treasury shares accounts for 95% or more of the total number of the company’s listed shares.

Compulsory Acquisition of a Minority Shareholding

In the past, there were no laws in Japan that gave a majority shareholder the right to compulsorily acquire the shares of minority shareholders. Unless all of the target’s shareholders agreed to sell their shares, full ownership was impossible. However, since 1999, there have been two takeover schemes that enable a form of “squeeze out”:

- A share exchange (kabushiki kokan) scheme allows a joint stock company to acquire all of the shares of another joint stock company with the approval of only two-thirds of the target’s shareholders.
- A share transfer (kabushiki iten) scheme allows the shareholders of an existing joint stock company to establish a new holding company for purposes of acquiring all of the shares of the existing company by means of a share exchange.
Share exchanges and share transfers are available only as between joint stock companies. A direct takeover of a joint stock company by a foreign company through a share exchange or share transfer is not allowed.

However, foreign investors that establish or have already established subsidiary companies using the joint stock company form will be able to take advantage of these schemes.

A new squeeze out scheme has recently become popular in Japan. This scheme involves the creation of class shares that are subject to a call option in favor of the company. Under the Companies Act, all outstanding shares of a joint stock company can be changed to “class shares with call options” by amending the articles of incorporation of the company through a special resolution of the shareholders.

After changing all of the outstanding shares to class shares with call options, the company can acquire all of the class shares with call options by giving common shares to major shareholders and cash to minority shareholders upon the exercise of the call option, which also requires a special shareholders’ resolution.

In addition, a more comprehensive form of squeeze out is available in the form of cash-out mergers and triangular mergers under the Companies Act, including minority squeeze outs and acquisitions of Japanese corporations using shares in foreign companies.
# Ownership Percentages (Voting Rights)

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
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<tbody>
<tr>
<td>90%</td>
<td>Special Controlling Relationship: shareholder approval of the controlled company will not be necessary in the case of a merger by absorption, a business transfer, a share exchange (kabushiki kokan) and an absorption-type company split</td>
</tr>
<tr>
<td>66.7%</td>
<td>Full control: ability to pass special resolutions</td>
</tr>
<tr>
<td>50.1%</td>
<td>Majority control: ability to pass ordinary resolutions</td>
</tr>
<tr>
<td>33.4%</td>
<td>Negative control: ability to veto special resolutions</td>
</tr>
<tr>
<td>10.0%</td>
<td>Right to request court to review proposed dissolution of the company</td>
</tr>
<tr>
<td>5.0%</td>
<td>If company is listed, disclosure of ownership above this level is required under the 5% rule</td>
</tr>
</tbody>
</table>
| 3.0%       | - Right to demand to inspect books, records and relevant documents of the company  
              - Right to request court to review majority decision not to remove a director for wrongdoing  
              - Right to demand court-supervised inspection of Company’s operation and finances |
| 1.0%       | Right to propose agenda items at shareholders’ meetings |
Offeror’s Board Approves TOB Launch

Start TOB
- Publish announcement in newspaper(s) or at EDINET with notice in a newspaper
- File TOB statement with the local finance bureau
- Send TOB statement to target company, relevant stock exchange and any other person who has filed a competing TOB statement

TOB Period Expires
20-60 business days after start

Publish Announcement/File TOB Results
Day after TOB period expires

Pay Purchase Price and Transfer Shares
As soon as practical after expiration of the TOB process
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>BOJ</td>
<td>Bank of Japan</td>
</tr>
<tr>
<td>Companies Act</td>
<td>Companies Act (Law No. 86 of 2005, as amended)</td>
</tr>
<tr>
<td>EDINET</td>
<td>Electronic Disclosure for Investor’s Network</td>
</tr>
<tr>
<td>FEFTA</td>
<td>Foreign Exchange and Foreign Trade Act (Law No. 228 of 1949, as amended)</td>
</tr>
<tr>
<td>FIEA</td>
<td>Financial Instruments and Exchange Act (Law No. 25 of 1948, as amended)</td>
</tr>
<tr>
<td>FSA</td>
<td>Financial Services Agency</td>
</tr>
<tr>
<td>FTC</td>
<td>Fair Trade Commission</td>
</tr>
<tr>
<td>GFC</td>
<td>The global financial crisis commencing late 2008</td>
</tr>
<tr>
<td>JASDAQ</td>
<td>Japan Association of Securities Dealers Automated Quotation</td>
</tr>
<tr>
<td>JASDEC</td>
<td>Japan Securities Depository Centre, Inc.</td>
</tr>
<tr>
<td>Listed company</td>
<td>A Japanese company the shares of which are listed on any of the six stock exchanges in Japan, being Tokyo (including Mothers), Osaka (including Hercules), Nagoya (including Centrex), Fukuoka, Sapporo or JASDAQ</td>
</tr>
<tr>
<td>Acronym</td>
<td>Description</td>
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<tr>
<td>PE</td>
<td>Permanent establishment</td>
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<tr>
<td>MOF</td>
<td>Minister of Finance</td>
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<tr>
<td>NTA</td>
<td>National Tax Administration</td>
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<tr>
<td>TOB</td>
<td>Takeover bid</td>
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<tr>
<td>ToSTNet</td>
<td>Tokyo Stock Exchange’s Trading Network System</td>
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<tr>
<td>TSE</td>
<td>Tokyo Stock Exchange</td>
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</table>
MALAYSIA
DISCLAIMER

It should be noted that the material in this book is designed to provide general information only. It is not offered as advice on any particular matter, whether it be legal, procedural or other, and should not be taken as such. The laws and regulations summarized in this book are current as of 10 December 2012. The authors expressly disclaim all liability to any person in respect of the consequences of anything done or omitted to be done wholly or partly in reliance upon the whole or any part of the contents of this book. No reader should act or refrain from acting on the basis of any matter contained in it without seeking specific professional advice on the particular facts and circumstances at issue.

This may qualify as "Attorney Advertising" requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome.
Although the legal framework for merger and acquisition activity in Malaysia is relatively straightforward, administrative processes complicate matters, both for prospective acquirers and vendors. In particular, the regulatory approvals process can often be lengthy and involve several regulatory bodies. There are also relevant statutes to consider, depending on whether the target company holds an operating license to carry out its business activities. For instance, a licensed telecommunication company will be regulated under the Communications and Multimedia Act 1998 and will be required to hold at least one of a number of licenses.
Share Versus Asset Purchase

In Malaysia, the task of gaining control can be approached as a share purchase or an asset purchase depending on the rationale for the acquisition, the resources of the acquirer, the financial health and viability of the target company, and other more technical factors such as tax and stamp duty considerations.

Depending on the type and nature of the assets to be acquired, the complications of acquiring assets are sometimes less than those of acquiring a company. Generally, if a company is acquired, proper due diligence needs to be conducted to investigate all its assets and liabilities, including contracts it may have entered into and other actual or contingent obligations. It is usually possible to buy an asset such as a property by itself, without any legal complications, unless the property is charged or subject to other encumbrances.

On the other hand, depending on the type and business operations of the target company, the purchase of shares may be simpler and involve less expense, as the underlying assets and operational contracts of the target company will not have to be separately transferred to, or assigned or novated in favor of, the purchaser.
Stamp Duties and Other Factors

In practice, stamp duties on the transfer of an asset can be greater than stamp duties payable on the transfer of shares. Stamp duties are generally payable by the purchaser but some parties may agree to split the duty payments equally between the purchaser and the vendor.

There is no broad-based capital gains tax in Malaysia. However with effect from 1 January 2010, Real Property Gains Tax on transactions in real property and real property companies has been reinstated (see Taxation Issues: Capital Gains Tax). Note also that while profits on the sale of shares are not subject to any capital gains tax, the gains would be subject to income tax if the vendors are in the business of trading shares.
Foreign Investment Restrictions

While welcoming foreign investment, the Malaysian government is also keen to achieve balanced development within the Malaysian economy, and strives to achieve a balance between rapid growth and reasonable participation by Malaysians in the economic development. In particular, one of the main objectives of the Malaysian government is to increase Malaysian and Bumiputera (the indigenous people of Malaysia) ownership of Malaysian incorporated companies and businesses. In order to realize these aims, the Malaysian government has adopted the National Vision Policy ("NVP"), which has the objective of ensuring that the ownership of all industries in the Malaysian economy (including property or assets as well as share capital in any Malaysian company) reflects at least 30% ownership by Bumiputeras. The remaining equity shareholding can be held by local non-Bumiputera interests or foreign interests or both.
Non-legal (Administrative) Control

Acquisition of Malaysian Companies

The Foreign Investment Committee ("FIC") was tasked with the implementation of the NVP. Until recently, the FIC monitored foreign equity participation in the economy through its guidelines ("FIC Guidelines"). There were two sets of FIC Guidelines: the Guideline on the Acquisition of Interests, Mergers and Takeovers by Local and Foreign Interests; and the Guideline on the Acquisition of Properties by Local and Foreign Interests. Under the FIC Guideline on the Acquisition of Interests, Mergers and Takeovers by Local and Foreign Interests, the acquisition of Malaysian companies by foreigners including the establishment of wholly owned subsidiaries, was subject to review by the FIC. Generally stated, the FIC Guidelines previously required that a Malaysian company be at least 30% owned by Bumiputeras (i.e., the indigenous people of Malaysia), although there were some exceptions to this rule in certain sectors.

There has however, been a shift in foreign investment policy recently. In April 2009, the Prime Minister of Malaysia announced the removal of the 30% Bumiputera equity requirement for 27 services sub-sectors.

On 30 June 2009, the Prime Minister announced further liberalization measures including the abolishment of the FIC and the repeal of the FIC Guidelines. The deregulation of the FIC and liberalization of certain restrictions are intended to stimulate growth and encourage further participation of foreign investments.

In October 2011, the Prime Minister announced the further liberalization of 17 service sub-sectors, the implementation of which will be carried out in phases from 2012 onwards. Some examples of these service sub-sectors which have been or will be fully liberalized include private hospitals, medical and dental specialists, architectural, engineering, legal, accounting (including auditing) and taxation, courier services, telecommunications (except for the category of content application service provider license), education (including private universities, international schools, technical and vocational schools, and skills training centers), as well as departmental and specialty stores.

This is not to say that restrictions on foreign investments in Malaysia have been wholly lifted. Notably, the Malaysian Government has stated that sectoral regulation by relevant government ministries and/or agencies continue to apply and these regulations commonly involve restrictions on foreign shareholding. For instance, in certain sectors and strategic industries such as banking, insurance, aviation, energy and infrastructure, equity conditions and foreign shareholding remain regulated.
Acquisition of Properties

While the FIC Guideline on the Acquisition of Properties by Local and Foreign Interests which imposed equity conditions on the acquisition of properties by foreign interests was repealed on 30 June 2009, a new Guideline on the Acquisition of Properties ("EPU Property Guidelines") issued by the Economic Planning Unit ("EPU") was introduced in its place. The EPU Property Guidelines provide for more lenient controls and less restrictions on the ownership of real property by foreign interests.

Under the EPU Property Guidelines, foreign interests are free to acquire commercial, industrial, agricultural and residential properties above the value of RM500,000 on condition that such acquisitions do not result in the dilution of Bumiputera or interests in the ownership of the said properties. However, as land matters fall within the purview of state governments, the relevant state government will continue to have authority and may impose further conditions in respect of real property transactions involving foreign interests.

EPU approval is required for real property transactions resulting in the dilution of Bumiputera or government interests in real property, as follows:

**Direct Acquisition** - where there is a dilution of Bumiputera or government interests in real property and the property is valued above RM20 million.

**Indirect Acquisition** - where there is indirect acquisition of real property by a foreign interest through acquisition of shares if:

- the transaction results in a change in control of the company owned by Bumiputera interest and/or government agency;
- real property makes up more than 50% of the company’s assets; and
- the real property is valued at more than RM20 million.

Where EPU approval is required under the EPU Property Guidelines, the EPU will impose certain equity and share capital conditions on the acquirer of the property, as follows:

**Equity Condition** - To have and to maintain at least 30% Bumiputera equity in the shareholding of the property holding company.

**Paid-up Capital Conditions** - To have an issued and paid-up capital of at least RM100,000 where the acquirer is a local company owned by local interest; or to have an issued and paid-up capital of at least RM250,000 where the acquirer is a local company owned by foreign interests.
Implementation of FIC Guidelines

As with the FIC Guidelines previously in force, the EPU Property Guidelines are not law but a reflection of governmental policy only. There are no legal sanctions against non-compliance with the guidelines but they can be enforced administratively through government departments exercising a regulatory role in the granting of relevant licenses, approvals, permits and in particular the relevant land office not allowing the transfer of properties unless compliance with the Bumiputera equity condition is met.

The EPU exempts, amongst others, the following transactions from the requirement to obtain EPU approval:

- Acquisition of residential units above RM250,000, by expatriates (serving the government or with a monthly salary of RM8,000 and above) or permanent residents, for accommodation purposes; Acquisition of residential units under the “Malaysia My Second Home” Program;
- Acquisition of property by companies with Multimedia Super Corridor ("MSC") status in MSC areas provided that the property is only used for operational activities (which may include using the property as employee residences);
- Acquisition of property in approved areas in any regional development corridor by certain approved companies
- Acquisition of property by companies which have obtained endorsement from the Secretariat of the Malaysian International Islamic Financial Centre ("MIFC")
- Acquisition of industrial property by manufacturing companies
- Acquisition of properties under privatization projects (provided the acquirer is the original signatory to the privatization contract)
- Acquisition of property by companies which have been granted the status of International Procurement Centre, Operational Headquarters, Representative Offices, Regional Offices, Labuan offshore companies and Bio-Nexus, or special status by the Ministry of Finance, Ministry of International Trade and Industry and other ministries
Listing on Bursa Malaysia Securities Berhad (Bursa Malaysia - previously, the Kuala Lumpur Stock Exchange)

In a bid to promote participation of foreign issuers on Bursa Malaysia, the local stock exchange, the Malaysian government has progressively liberalized the foreign equity requirements for listings on Bursa Malaysia. For instance, from 30 June 2009 onwards:

- the minimum Bumiputera equity participation in a Malaysian listed entity has been reduced from 30% upon listing to half of the public spread requirement of 25% at the point of listing; and
- companies with MSC status, BioNexus status, and those with predominantly foreign-based operations are exempted from the Bumiputera equity requirement.

Legal Control

Legal Control is exercised through administrative discretion conferred under statutes or subsidiary legislation. Equity ownership can be controlled through the issuance of licenses, permits and employment passes or in the purchase of real property and acquisition of any interest in real property. Equity conditions may be imposed on licenses or approvals required for initial public offerings and which are granted by government or statutory bodies such as the Malaysian Securities Commission ("SC"), as discussed below.

In a share acquisition, the approval of the relevant licensing body must also be taken into consideration. The licensing conditions may stipulate that the approval of the appropriate licensing body must be obtained for any transfer of the shares in the licensed entity.

Competition Law

Until fairly recently, there were generally no anti-trust laws in Malaysia. Parties seeking to restrict anti-competition conduct could only rely on sector-specific legislation and guidelines prohibiting anti-competitive behavior, notably in the telecommunications, media, energy and franchise sectors.
In May 2010, Malaysia introduced a general competition law similar to the Singapore and United Kingdom models by the passing of the Malaysian Competition Act 2010 (“MCA”) and the Competition Commission Act 2010 (“CCA”). The CCA came into force on 1 January 2011, whilst the MCA came into force on 1 January 2012.

The main objective of the MCA is to regulate agreements between companies which have the (a) object or effect of significantly preventing, restricting or distorting competition in any market for goods or services in Malaysia; or (b) conduct which amounts to abuse of dominance in the relevant market. There is no merger control regime under the MCA.

The MCA is enforced by the Malaysian Competition Commission (“MyCC”), a new government authority which was formed on 1 April 2011 pursuant to the CCA. The MyCC has a broad range of powers and duties under the CCA, from advising the Minister or any public or regulatory authority on competition matters, to educating and raising awareness regarding the benefits of competition law among the members of the public.

Notwithstanding the MCA and CCA, note that the MCA does not supersede the sector-specific legislations which provide for anti-competitive regulations. In fact, the MCA specifically carved out commercial activities regulated under these legislation from its scope.

Exchange Controls

The relevant legislation in Malaysia governing exchange control is the Exchange Control Act 1953. The Controller has, under Section 39 of the Act, issued the Exchange Control Notices of Malaysia (“ECMs”) that constitute the Controller’s general permissions and directions. In certain instances, the specific approval of the Controller is still required.

With the removal of significant restrictions in April 2007, the Central Bank of Malaysia (Bank Negara Malaysia --“BNM”) has placed the regulatory regime of exchange control back to the position that applied before 1 September 1998. Indeed, in some instances, the regulatory scheme has been eased such that in some respects, it is more liberal than the regulations prevailing at the time prior to the Asian Financial Crisis of 1997/98, thus lending support to the government’s assertion that Malaysia no longer has any capital controls.
The key regulations governing investments abroad are as follows:

- **Residents** without domestic credit facilities can invest abroad in foreign currency either from their own foreign currency or conversion of ringgit funds without limit. Resident individuals with domestic credit facilities can invest abroad up to RM1 million per annum, while resident corporations with domestic credit facilities can invest in foreign currency assets up to RM50 million per annum (on a corporate group basis). Resident corporations which meet the prudential requirements stipulated by BNM are exempt from the prevailing limit of RM50 million and are permitted to undertake any amount of direct investment abroad.

- The threshold for investing abroad funds attributed to residents by a **unit trust company** has been increased to 100% of the Net Asset Value ("NAV") of all resident funds attributable to residents that do not have domestic credit facilities, and 50% of the NAV attributable to residents with domestic credit facilities. There continues to be no restriction on investment abroad for funds attributed to non-resident clients.

- **Fund managers** may invest abroad any amount of funds belonging to non-resident clients and resident clients that do not have any domestic credit facilities, and up to 50% of funds of residents with domestic credit facilities.

- **Insurance companies** and takaful (Shariah-compliant insurance) operators may also invest abroad up to 50% of the NAV of the investment-linked funds that they market.

- To promote Malaysia as an Islamic Financial Centre and a center for origination of **Shariah-compliant investment** instruments, the thresholds (i.e., the limit of 50% of the NAV of all the resident funds managed by unit trust companies and 50% of total funds attributable to residents with domestic ringgit borrowing managed by fund management companies) do not apply to investments of Islamic funds in foreign currency assets.

- To facilitate the trading of US dollar denominated crude palm oil futures contracts ("USD FUPO"), investments in the USD FUPO by residents are excluded from the rules of investment in foreign currency asset if payments are made in ringgit and ringgit is received in respect of those investments.

Between 2008 and 2012, the Central Bank of Malaysia announced further liberalization on the rules of borrowing and lending by residents.
• A resident company is now free to borrow any amount in foreign currency from its resident related companies, non-resident non-bank related companies, other non-residents including financial institutions and related non-bank non-resident company (other than those that are solely set up to obtain foreign currency credit facilities), licensed onshore banks, and licensed International Islamic Banks, and up to RM100 million equivalent in aggregate (on a corporate group basis) from other non-residents.

• A resident individual is free to borrow in foreign currency, up to RM10 million equivalent in aggregate from non-residents, licensed onshore banks or licensed International Islamic Banks.

• A resident company is permitted to obtain any amount of foreign currency as supplier’s credit to finance purchases from a non-resident supplier and is allowed to refinance outstanding approved foreign currency borrowing (including principal and accrued interest).

• A resident company is further allowed to borrow in Ringgit, any amount from its non-resident non-bank related companies (other than those that are solely set up to obtain foreign currency credit facilities) to finance activities in the real sector in Malaysia, although it remains that only up to RM1 million in aggregate may be borrowed from other non-resident non-bank companies or individuals for use in Malaysia.

• A resident individual is also free to borrow in ringgit, up to RM1 million in aggregate from non-resident non-bank companies or individuals for use in Malaysia.

Previously, any borrowing in ringgit from non-residents required the permission of the Central Bank of Malaysia.

• International Islamic banks are allowed to borrow or lend any amount in foreign currency, with any person in or outside Malaysia.

• A resident company or individual and a licensed onshore bank can now lend in ringgit any amount to non-resident non-bank companies or individuals to finance activities in the real sector in Malaysia.

**Malaysia’s Exchange Control Regime**

• Residents are free to **settle payments** for import of goods and services in both foreign currency or ringgit.
Residents and non-residents are now free to import and export ringgit notes up to the equivalent of USD10,000; and any amount of foreign currency notes and traveller’s cheque. The limits on import and export of foreign currency notes and traveller’s cheque have been abolished.

All international Islamic banks, international takaful operators, international currency business units of licensed onshore banks and takaful or retakaful operators are allowed to make payment in foreign currency to resident intermediaries for the financial services rendered by those intermediaries.

International Islamic banks are allowed to buy or sell foreign currency against another foreign currency with any person in or outside Malaysia.

There is no restriction on repatriation of capital, profits, dividends, interest, fees or rental by foreign direct investors or portfolio investors.

Ringgit assets purchased by residents from non-residents may be settled in ringgit or foreign currency, subject to prevailing rules on investment in foreign currency assets.

Non-residents may transfer ringgit securities to another non-resident, where settlement for such transfers may be made in ringgit (if settled in Malaysia) or in foreign currency (if settled outside Malaysia).

Companies with MSC status will continue to be exempted from all exchange control rules.

An Approved Operational Headquarters (“OHQ”) is allowed to obtain any amount of credit facilities in ringgit or foreign currency from any lender for any purpose.

Corporate and Securities Law Issues

Capital Markets and Services Act 2007

The Malaysian Government introduced the Capital Markets and Services Act 2007 (“CMSA”) to consolidate the previous Securities Industry Act 1983 and Futures Industry Act 1993. Most of the provisions of the CMSA came into force on 28 September 2007, and the rest of the provisions are expected to come into effect soon. The CMSA is anticipated to achieve an optimal balance between market flexibility and liberalization on the one hand, and regulation and investor protection on the other.
Acquisition or Disposal of the Company’s Undertaking or Property

Section 132C of the Malaysian Companies Act 1965 provides that if a company is disposing of a substantial portion of its undertaking or property, the approval of its shareholders at a general meeting must be obtained. Further, Section 132C also provides that the approval of the shareholders must be obtained for a company to acquire an undertaking or property of a substantial value. Where the company is a listed company, the transaction will require shareholder approval if it triggers the relative figures which require the approval of the shareholders as set out in the Main Market Listing Requirements of Bursa Malaysia Securities Berhad (Listing Requirements). (Please refer to the section on Public or Listed Company Considerations: Specific Disclosure Obligations.)

If the company is not a listed entity, an undertaking or property shall be considered to be of “substantial value” or “substantial portion” if: its value exceeds 25% of the total assets of the company; the net profits attributed to it amount to more than 25% of the total net profit of the company; or its value exceeds 25% of the issued share capital of the company, whichever is the highest.

Consideration Shares

The approval of the shareholders of the purchaser may be required when the allotment and issue of shares in the purchaser constitutes part or all of the purchase price for the acquisition of shares or assets in the target.

Such approval is necessary if the allotment and issue leads to an increase in authorized capital of the purchaser (Section 62 of the MCA) or exceeds the existing authority of the directors to allot and issue shares (Section 132D of the MCA). However, in the latter case, Section 132D(6A) of the MCA exempts the directors from having to obtain the authority or approval of the shareholders for share issues that are made as consideration for the acquisition of shares or assets by the issuing company, provided that the shareholders have been notified of the intention to issue the shares at least 14 days before the date of issue.
Connected Transactions

Section 132E of the MCA requires approval of the shareholders of a company where: the transaction is between the company and its director (or a director of its holding company or a person connected with such directors) or its substantial shareholder (or a substantial shareholder of the holding company or a person connected with such substantial shareholders) and involves the acquisition or disposal of non-cash assets (including shares) with a requisite value set out under the MCA.

Substantial shareholder means a person holding at least 5% of the voting shares of a company.

Specific Industry Regulation

Generally, it is government policy (rather than statute) that limits acquisitions in specific industries, although certain Malaysian legislation (such as that governing banking) sets caps on foreign equity participation in Malaysian companies operating in particular industries. Generally, the broad principles of the NVP are applied and the Malaysian government policy imposed on foreign participation varies between industries.
Non-regulatory consents and approvals are left to the administrative discretion of various government bodies. As discussed above, equity ownership imposed under the NVP can be controlled through, amongst others, the issuance of licenses, permits and employment passes, or in the purchase of real property and acquisition of any interest in real property. These requirements are subject to change from time to time.
Jurisdiction Tax

Income Tax

In Malaysia, profits derived by the transferor from the disposal of trading stock would be taxable at the normal corporate income tax rate. This is currently 25% for assessment years 2009 and beyond.

There is a concessionary tax rate for Malaysian resident companies with a paid-up capital of RM2.5 million or less (these companies are commonly referred to as small and medium enterprises or SMEs). SMEs are subject to income tax at the rate of 20% on the first RM500,000 of their chargeable income. The remaining chargeable income will continue to be taxed at the normal corporate tax rate (i.e., 25% for assessment years 2009 and beyond). However, the definition of a SME has recently been changed such that the concessionary tax rate will only apply if the SME is not directly or indirectly related to a non-SME.

When trading stock is sold upon the discontinuance of a trade or business, the value of the trading stock sold is prescribed by Section 35 of the Income Tax Act 1967 (“Income Tax Act”) which provides that the value shall be equal to the purchase price (or value of consideration) where the transferee intends to carry on a trade or business in Malaysia and where the trading stock would be deductible as an expense in the transferee’s business. Otherwise, the transfer and all associated tax consequences are deemed to occur at market value.
Generally, the transfer of depreciable capital assets does not attract income tax unless capital allowances have been granted and the disposal value exceeds the tax written-down value of the assets, resulting in a balancing charge in respect of which the transferor becomes subject to corporate income tax. There is, however, a provision in the Income Tax Act for the transfer of such assets on a rollover basis between related parties. Disposal value will normally be the sale price but for real property, the market price, if higher, will be used.

Carrying Forward Net Operating Losses Following a Change in Ownership

In Malaysia, a company is entitled to carry forward business losses incurred in one year of assessment for deduction against its statutory income in future years. However, unlike in Singapore, unabsorbed business losses may only be offset against future income from business sources.

Previously, accumulated losses of a company could not be carried forward if there was a change of more than 50% in the shareholding of the company during the relevant year. However, the present position is that a company experiencing a substantial change in shareholding (50% or more) may carry forward unabsorbed accumulated losses and capital allowances to be absorbed in that year of assessment and the following years after, except where the substantial change in shareholding occurs in a dormant company. In other words, only dormant companies with a change in substantial shareholding of at least 50% will be disallowed from carrying forward unabsorbed accumulated losses and capital allowances.

The Income Tax Act provides group relief for all locally incorporated resident companies limited to 70% (raised from 50%) of current year unabsorbed losses to be offset against income of another company within the same group, subject to certain conditions.

Capital Gains Tax

Like Singapore, Malaysia does not impose capital gains tax. However, the taxation of gains from transactions in real property and real property companies has been reinstated with effect from 1 January 2010. Currently, any disposal of real property or share in a real property company within two years will attract real property gains tax at the rate of 10%, disposal between two to five years will attract real property gains tax at the rate of 5%, whilst any disposal after five years from the
date of acquisition is exempted from tax. Effective 1 January 2013, the rates have been revised as follows:

(a) Disposal of any real property or share in a real property company within two years will attract real property gains tax at the rate of 15%.

(b) Disposal of any real property or share in a real property company between two to five years from date of acquisition will attract real property gains tax at the rate of 10%. Any disposal after five years is exempted.

Withholding Tax System

Malaysia imposes a withholding tax on certain payments to non-Residents, such as royalties, technical fees, installation fees and rental of moveable property, where the payments are sourced or deemed sourced in (i.e., accrued in or derived from) Malaysia. Dividends are not subject to withholding tax in Malaysia. With effect from 1 January 2009, payments to non-residents that would fall within Section 4(f) of the Income Tax Act are also subject to withholding tax in Malaysia (pursuant to a new Section 15B). Some examples of Section 4(f) income would be guarantee fees, commissions and introducers’ fees.

There are provisions in the Income Tax Act that deem certain types of income (e.g., interest, royalties, technical fees and rental of movable properties) to be sourced in Malaysia if they are broadly:

- borne by a Malaysian resident or permanent establishment; or
- deductible against Malaysian taxable income.

However, with effect from 21 September 2002, payments to non-residents for certain services performed outside Malaysia will be exempted from withholding tax. The exemption specifically applies to services rendered in respect of technical advice, assistance or technical services in relation to the management or administration of any project, or services rendered in connection with the use of property or rights belonging to, or the installation or operation of any plant machinery or apparatus purchased from the non-resident.

However, the introduction of withholding tax on section 4(f) income does not appear to distinguish between payments made in respect of services performed in Malaysia from those that are conducted outside Malaysia. With the imposition of withholding tax on Section 4(f) income, it is anticipated that most, if not all, payments made to non-residents can now be captured as Section 4(f) income and therefore be subject to withholding tax.
The withholding tax rates for the payments of interest, royalties, rent, technical assistance, management fees and Section 4(f) income to non-residents are as follows:

<table>
<thead>
<tr>
<th>Type of Payment</th>
<th>Withholding Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest</td>
<td>15%</td>
</tr>
<tr>
<td>Royalties</td>
<td>10%</td>
</tr>
<tr>
<td>Technical assistance fees (Onshore)</td>
<td>10%, possibly 13% where employees of the foreign service providers are sent to Malaysia to deliver the services</td>
</tr>
<tr>
<td>Rent</td>
<td>10%</td>
</tr>
<tr>
<td>Management fees (Onshore)</td>
<td>10%</td>
</tr>
<tr>
<td>Section 4(f) income</td>
<td>10%</td>
</tr>
</tbody>
</table>

Withholding taxes may also be reduced by tax treaties.

**Transactional Tax**

**Stamp Duty**

In general, in a share acquisition the purchaser pays stamp duty of 0.3% of the purchase price paid or of the market value, whichever is higher. However, mutual agreement between the parties to allow the cost to be borne by either or both of the parties is possible.

In an asset acquisition, depending on the type of assets in question, it may be possible to structure the acquisition such that legal title to the assets is transferred by physical delivery. This would preclude the agreement becoming an instrument of conveyance and the agreement should therefore be subject to nominal stamp duty. However, certain assets (e.g., land and shares) may only be transferred through prescribed instruments of transfers. These instruments will incur stamp duty levied on an ad valorem (according to value) basis. Further, legal assignments of assets will similarly be subject to stamp duty on an ad valorem basis.
The Employment Act governs all matters relating to employment in West Malaysia and (with the exception of public servants and those employed by statutory entities) applies to all employees whose wages do not exceed RM2,000 a month and all those engaged in manual labor. All other workers are governed by their employment contracts and the common law.

The main areas covered by the Employment Act concern termination, payment of wages, liability of principals and contractors for wages, employment of women, maternity protection, days and hours of work, annual leave, sick leave, public holidays, termination and lay-off benefits, inspection of places of employment and methods of dealing with complaints and domestic enquiries. There are no statutory minimum wages, and actual conditions of employment can usually be agreed upon between the relevant parties, subject to the minimum terms set out in the Employment Act where these are applicable.

Termination and lay-off benefits in respect of Employees are prescribed under the Employment (Termination and Lay-Off Benefits) Regulations 1980. With regard to other employees, arrangements relating to retrenchment or redundancy can be addressed in a contract of service or collective agreement.

Dismissal of any employee must be for a just cause or excuse. Even where there is just cause for dismissal, the dismissal must follow certain inquiry procedures, failing which, the employee may appeal to the Minister of Human Resources and through him to the Industrial Court for reinstatement. The employer is also required to notify the Director-General of Labour of the retrenchment of any employees at least one month prior to the retrenchment exercise.
Preliminary Agreement - Memorandum of Understanding/ Letter of Intent

A memorandum of understanding ("MOU") / letter of intent is relatively common in Malaysia as a precursor to definitive agreements. It is sometimes entered into to clearly spell out the responsibilities of the parties involved in the transaction. Further, MOUs containing exclusivity clauses may also serve to prevent the parties from negotiating with other third parties.

Depending on the intention of the parties and the way it is drafted, an MOU or a letter of intent can be a binding contract between the parties involved. However, an agreement to agree is generally not enforceable under Malaysian law. If the intention of the parties is not to be bound by the MOU or the letter of intent, care must be taken in the drafting of the document to reflect such an intention.

Due Diligence

Due diligence is a common feature of acquisition transactions in Malaysia. Purchasers are generally encouraged to conduct proper due diligence on the assets or shares they propose to purchase to avoid complications in the course of undertaking the acquisition and after the acquisition.

As for acquisitions or takeover of shares in listed companies, due diligence on the public documents relating to the offer has become essential. The CMSA requires information given in any document relating to the takeover, for instance
a takeover offer document, to be true, accurate, not misleading and not contain any material omission. In the case where misleading information is located in the offer document, it would be a defense, if it can be shown, that the offeror has conducted proper due diligence and has reasonable grounds to believe that the information was not misleading or untrue at the time of disclosure.

Further, there are also strict insider trading laws that prohibit parties from providing material non-public, price sensitive information to a potential purchaser, and a potential purchaser in possession of such information cannot acquire the shares.

A potential acquirer of shares in a listed company may also seek comfort from the obligation imposed on the listed company to disclose proper corporate information relating to its business activities. Bursa Malaysia has stressed that its corporate disclosure policy forms part of the continuing listing requirements to which the listed company is subject. Among others, these include rules relating to:

- immediate public disclosure of material information;
- thorough public dissemination of material information;
- clarification or confirmation of rumors and reports;
- unwarranted promotional disclosure; and
- insider trading.

**Documentation and Agreements**

In Malaysia, it is common for the purchaser’s lawyers to prepare the first draft of the acquisition documentation and agreements.

In a takeover offer transaction, both the offeror/acquirer and the target company would be obliged to prepare the necessary statutory documents and other relevant documents to inform, amongst others, the authorities and the shareholders of the offeree of the proposed takeover offer. The offeror/acquirer is therefore required to prepare an offer document and the target company an independent advice circular for its shareholders. Both documents are required to contain information that is true, not misleading and devoid of material omissions.
Representations and Warranties

Representations and warranties are commonly found in most acquisition agreements in Malaysia. Assurances may be obtained that the purchaser has been properly authorized according to the purchaser’s internal rules. Also, the vendor is typically required to warrant that it has the authority to sell, for instance, its assets to the purchaser.

Further, the vendor is likely to warrant the condition of the business of the target company in considerable detail. Warranties will include the financial position of the vendor, its commitments and contingencies, records and returns, and its title and insurance, among others.

Checklist for Provisions in an Acquisition Agreement

Checklists may vary on a case-by-case basis. A tailor-made checklist can therefore be prepared for different transactions.

Completion

Completion of a transaction is generally effected following the satisfaction of conditions precedent specified in the transaction agreements. For instance, the acquisition of shares in a manufacturing company may require the consent of the Ministry of International Trade and Industry. If the necessary approvals are not obtained in a specified time period, the parties may either waive the condition or terminate the transaction.
Acquisition of a Substantial Shareholding

Insider Trading

Section 188 of the CMSA sets out stringent regulation of insider trading. Effectively, an insider (defined as a person who possesses information that is not generally available which, on becoming generally available, a reasonable person would expect it to have a material effect on the price or the value of securities and who knows, or ought reasonably to know, that the information is not generally available) shall not:

- acquire or dispose of, or enter into an agreement for or with a view to, the acquisition or disposal of such securities; or
- procure (whether directly or indirectly) an acquisition or disposal, or enter into an agreement for or with a view to, the acquisition or disposal, of such securities.

An insider is also prohibited from, directly or indirectly, communicating insider information to a person whom the insider knows, or ought to reasonably know, would deal in the securities.

The word information is defined widely and includes matters of supposition and other matters that are insufficiently definite to warrant being made known to the public, information relating to the financial performance of a corporation, existence of negotiations, matters relating to the future and so on.
A person who contravenes, or fails to comply with, the provisions is liable upon conviction to a fine of not less than RM1 million and imprisonment for a term not exceeding 10 years.

The CMSA also empowers the SC to institute civil proceedings against the offending person whether or not the person has been charged for the offense or whether or not a contravention has been proved in a criminal prosecution. There is also a provision to allow for a person who has suffered loss or damage by reason of relying on the conduct of another person who has contravened the statutory provisions above, to institute civil proceedings against that person whether or not the person has been charged for the offense or whether or not a contravention has been proved in a criminal prosecution.

**Takeovers Code**

In Malaysia, the main legal framework governing the conduct of public company takeovers is contained within Division 2 of Part VI of the Capital Markets and Services Act 2007 and the Malaysian Code on Takeovers and Mergers 2010 ("**Malaysian Code**"). The Malaysian Code should be read together with the practice notes ("**Practice Notes**") issued by the SC.

The SC is the principal regulatory authority in the context of takeovers.

To the extent that the target company is listed on Bursa Malaysia, the listing requirements issued by Bursa Malaysia must be adhered to.

The Malaysian Code applies to both listed and unlisted Malaysian incorporated public companies (where such companies satisfy certain criteria specified below). It also applies to a company incorporated outside Malaysia but listed on Bursa Malaysia, and a real estate investment trust that is listed on the Bursa Malaysia.

The Malaysian Code can also apply to “upstream acquisitions”; for example, when an acquirer acquires an upstream company (to which per se the Malaysian Code does not apply) and, as a result of this acquisition, the acquirer gains a controlling interest in a downstream company to which the Malaysian Code applies.

The Malaysian Code’s basic objectives are to ensure that shareholders of
the target company are treated equally and fairly and given all the relevant information they need to assess the offer and to decide whether or not to accept it.

Generally, an acquirer may build its stake in the target company either by acquiring a large stake from a substantial shareholder or by making direct purchases from the stock market. However, the requirement to comply with a substantial shareholder disclosure regime contained in Division 3A of Part IV of the MCA makes it difficult for any person to build up a secret stake in a target company in order to make a dawn raid. This regime is triggered following the acquisition of a 5% interest. It also applies to a wide variety of indirect interests.

Mandatory Offer Obligation

Section 9 of the Malaysian Code requires a mandatory takeover offer to be made to the holders of the remaining voting shares where:

- any person acquires (taken together with shares held or acquired by its concert parties) control in a company, i.e., more than 33% of that company’s voting shares; or
- any person who, together with its concert parties, holds more than 33% but less than 50% of the voting shares of a company and, acting alone or in concert, acquires more than 2% of the remaining voting shares in the company in any six-month period.

The offer for such shares must be not less than the highest price (excluding stamp duty and commission) paid or agreed to be paid by the offeror (or its concert parties) for the shares in the target company within the six months prior to the offer period. Any mandatory general offer which has to be made to all the shareholders as a result of the acquisition of control of a Malaysian company shall not be subject to any condition, save for the condition that the offeror must receive acceptances which would result in the offeror holding more than 50% of the voting shares to which the takeover offer relates.

Announcements

The Malaysian Code requires a potential offeror to immediately announce the proposed offer by way of a press notice. Once the offeror has triggered a mandatory takeover offer, the offeror is required to immediately announce the takeover offer by way of a press notice, followed by a dispatch of a written notice to the board of directors of the company or its advisor, the relevant stock exchange

Guide to Mergers and Acquisitions
(if the voting shares are listed) and the SC. Once an announcement of an intention to make a takeover offer is made, the proposed offeror shall not withdraw the takeover offer without the prior permission of the SC.

A potential offeror should also note that where there is untoward movement or increase in the volume of share turnover of the company, it is under an obligation to make an announcement as to whether there is a takeover or a possible takeover offer. The Malaysian Code has also introduced the concept of “put up or shut up” to prevent a company from suffering from a protracted period of speculation before a firm offer announcement is released by the potential offeror.

The board of the offeree company shall, within 24 hours of the receipt of the notice, release an announcement on the Stock Exchange or by way of a press notice to indicate its receipt of the notice and dispatch the announcement to the offeree’s shareholders within seven days of the receipt of the written notice.

The Malaysian Code sets out in detail the requirements in respect of a takeover offer, including the information to be provided in press notices, the form and content of the offer document, the obligations of the board of the target company, the terms of the offer, the determination of the offer price, the consideration for the offer, the timing of the offer, and the respective obligations of the offeror and the offeree.

**Compulsory Acquisition of a Minority Shareholding**

Under the CMSA, where a takeover offer by an offeror to acquire all the shares or all the shares in any particular class in an offeree has, within four months of the offer being made, been accepted by holders of at least nine-tenths of the nominal value of those shares or shares of that class (excluding shares already held at the date of the takeover offer by the offeror or persons acting in concert with the offeror), the offeror may, within two months after the offer has been so accepted, give notice to any dissenting shareholder that it desires to acquire his or her shares.

Upon the expiration of one month from the notice, and subject to the offeror supplying the dissenting shareholder with a list of the other dissenting shareholders upon request, the offeror will be bound and entitled to acquire those shares, unless the court makes an order to the contrary upon the application of the dissenting shareholder. Any such application by the dissenting shareholder must be made within a period of one month from the date notice is served on the dissenting shareholder in question.
Listing Requirements

Generally, if an offeror has received acceptances that bring the holdings owned by it and its concert parties to at least 90% of the target company’s listed shares and there has been an announcement that the offeror does not intend to maintain the listing status of the target company, the offeror can procure the target company to withdraw its listing from the Main Market or the Ace Market of Bursa Malaysia (depending on which Board the company is listed).

If the offeror is of the view that the listed status of the target company is of considerable value and should be maintained, steps will have to be taken (whether by way of a placement or other corporate exercise) to bring the public shareholding spread of the target company to the requisite level.

Even in the case where the level of acceptance is below 90%, the target company continues to be obligated to ensure that it is compliant with the public shareholding spread requirement. Announcements must be made if the target company ceases to have a public spread.

If the listed company does not comply with spread requirements, it could be in breach of the Listing Requirements and subject to suspension in the trading of its securities or ultimately, delisting. Upon the completion of the takeover offer, the listed company must furnish a schedule of the company’s securities to Bursa Malaysia in the format set out in the Listing Requirements. This schedule generally requires the company to list the shareholdings in the company.

Timetable

An offer must initially be kept open for at least 21 days, starting from the date on which the offer document is posted. If the offer is revised, it must be kept open for at least 14 days from the date of posting of the revision to shareholders. No offer may be revised after the 46th day of its posting.

If an offer becomes, or has been declared, unconditional as to acceptances by the date of posting of the offer document, the closing date should be no later than the 60th day from the posting date.

Where a takeover offer is declared unconditional on any day before the 46th day from the date of posting of the offer document, the closing date must be no earlier than the expiry of 14 days from the date the offer is, or is declared to be, unconditional, provided that this closing date is no later than the 60th day from the posting date.
Where the takeover offer is declared unconditional on any day after the 46th
day from the date of posting of the offer document, the closing date must be no
earlier than the expiry of 14 days from the date the offer is, or is declared to be,
unconditional, provided that this closing date is no later than the 74th day from
the posting date.

Generally, a takeover offer lapses if the offeror has not received acceptances
that would result in the offeror and all persons acting in concert with the offeror
holding, in aggregate, more than 50% of the voting shares of the company to
which the takeover offer relates, by 5 p.m. on the 60th day after the date on which
the offer is initially posted.

If the securities or voting shares of the offeror or offeree are listed on a stock
exchange, the offeror shall announce the level of acceptances on the next market
day following the day on which an offer is closed, becomes, or is declared,
unconditional as to acceptances, or is revised or extended.

<table>
<thead>
<tr>
<th>Main Board Requirements</th>
</tr>
</thead>
</table>
| • Uninterrupted aggregate Profit After Tax ("PAT") for the past three to five
  full financial years of at least RM20 million and minimum PAT of RM6
  million in the latest financial year; or market capitalization of minimum
  RM500 million; and at least one full year of operating revenue; |
| • At least 25% of its listed shares are in the hands of a minimum of 1,000
  public shareholders each holding not less than 100 shares each; and |
| • 50% of the 25% public spread is required to be allocated for Bumiputera
  participation (i.e., Bumiputera shareholding must be 12.5%). |

<table>
<thead>
<tr>
<th>Ace Market Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>• No minimum operating track record or profit requirement.</td>
</tr>
</tbody>
</table>
| • At least 25% of its listed shares are in the hands of a minimum of 200 public
  shareholders. |
Under the Listing Requirements, issued and paid-up capital of the company held by employees and Bumiputera investors [for the purposes of the NVP] are allowed to make up the 25% public shareholding spread. A listed company must inform Bursa Malaysia immediately if it becomes aware that it does not comply with the required shareholding spread. In such circumstances, the listed company may request an extension of time to rectify the situation. Where no extension of time is granted by Bursa Malaysia, Bursa Malaysia may suspend trading in the securities of the listed company and/or delist the company. In the event that the shareholding spread is 10% or less, Bursa Malaysia may suspend trading in the securities.

The penalties for breach of any requirement under the Listing Requirements, including the spread requirements discussed above, include a public reprimand, the delisting of the company, a fine not exceeding RM1 million, the suspension in the trading of the securities for any period of time, or the restriction of dealing in the securities of the errant company to immediate or prompt bargains (i.e., the shares of the errant company can only be traded if cash is paid upon the purchase of those shares). Bursa Malaysia is also empowered to impose any other conditions or penalties as it may see fit.

Acquisitions and Disclosures by Public Companies

A takeover of a listed company can proceed in any one of the following ways:

- An investor may participate in a rights issue, or through a private placement of a public company, and as a consequence acquire control of the public company.
- Through a scheme or takeover governed by the Malaysian Code.
- An investor may be able to achieve a backdoor listing through the sale of assets, businesses or interests to a listed company and the issue of shares to the vendor company, resulting in a change of control in the listed company through the introduction of a new dominant shareholder or group of shareholders.
General Disclosure Obligation

The Listing Requirements provide for continuing disclosure obligations of a public company. These continuing obligations include the obligation to notify Bursa Malaysia of any information concerning the company or any of its subsidiaries necessary to avoid the establishment of a false market in the company’s securities or which would be likely to materially affect the price of its securities; any change in management; any notice of substantial shareholdings or changes thereto received by the company and details thereof; and any acquisition of shares in either a listed or unlisted company that exceeds a specified limit.

Specific Disclosure Obligations

Transactions Exceeding the Value of 5%

In a transaction where any of the relative figures below equals or exceeds 5% of the percentage ratio as soon as possible after terms have been agreed, an announcement should be given to Bursa Malaysia (for release to the market and consequently to the press), detailing the information prescribed by the Listing Requirements.

The 5% threshold applies for:

- the value of the assets that are the subject matter of the transaction, compared with the net assets of the listed issuer;
- net profits (after deducting all charges and taxation and excluding extraordinary items) attributable to the assets that are the subject matter of the transaction, compared with the net profits of the listed issuer;
- the aggregate value of the consideration given or received in relation to the transaction, compared with the net assets of the listed issuer;
- the equity share capital issued by the listed issuer as consideration for an acquisition, compared with the equity share capital previously in issue (excluding treasury shares);
- the aggregate value of the consideration given or received in relation to the transaction, compared with the market value of all the ordinary shares of the listed issuer (excluding treasury shares);
- the total assets which are the subject matter of the transaction compared with the total assets of the listed issuer;
• in respect of joint ventures, business transactions or arrangements, the total project cost attributable to the listed issuer compared with the total assets of the listed issuer; or in the case where a joint venture company is incorporated as a result of the joint venture, the total equity participation of the listed issuer in the joint venture company (based on the eventual issued capital of the joint venture company) compared with the net assets of the listed issuer; the value of the transaction should include shareholders’ loans and guarantees to be given by the listed issuer; or

• the aggregate original cost of investment of the subject matter of the transaction divided by the net assets of the listed issuer, in the case of a disposal and where the acquisition of the subject matter took place within the last five years.

Transactions Exceeding 25%

For a transaction where the relative figures as set out above equals or exceeds 25%, in addition to the requirement to make an announcement to Bursa Malaysia, the transaction should be made conditional upon approval by the shareholders of the company at a general meeting. A circular detailing the information prescribed by the Listing Requirements must also be sent to the shareholders.

The specific disclosure obligations and the necessity to seek shareholder approval as set out above will not apply if the value of the consideration given or received in relation to the transaction is less than RM250,000.

Other Disclosure Obligations

There are similar disclosure obligations, for instance, where a company is involved in a transaction concerning the interests of directors or substantial shareholders or persons connected to the directors or substantial shareholders.

Connected Transactions

If a company proposes to sell any company, business or asset to a director, past director, major shareholder or past major shareholder of either the company, its subsidiaries or its parent company, or to acquire an interest in any company, business or asset in which such a person is interested, the prior approval of the shareholders for the transaction will have to be sought at a general meeting if the percentage ratio for the transaction is 5% or more. For this purpose, a circular containing the minimum prescribed information in the Listing Requirements will also have to be despatched to the shareholders. It is also likely that the MCA
will impose conditions, such as obtaining shareholder approval, where there are related party transactions.

The same requirements apply in cases of joint ventures, business Transactions, or arrangements that involve the interests of directors or major shareholders, past and present.

**Disclosure-Based Regulatory Regime**

In 2003, the SC completed the move from a merit-based to a disclosure-based regulatory ("DBR") regime in connection with the issue and offer of securities.

The DBR regime offered a more streamlined regulatory approach, a quicker approval process, and more business friendly and market-based rules. Most importantly, it also means that issuers now have greater freedom and flexibility to price securities offered to the market.

The DBR regime is characterized by a twin track regulatory review process involving:

- a “declaratory approach” in respect of securities issues such as rights issues, bonus issues and employee share option schemes; and

- an “assessment approach” in relation to IPOs, reverse takeovers, mergers and acquisitions and proposals relating to financially distressed listed entities.

Pursuant to the declaratory approach, the Commission will grant approvals for proposals provided that the issuer and its principal adviser declare that relevant regulations and procedures have been complied with. The assessment approach will involve more focused review of the suitability of the proposal.

**Amendments to Securities Laws**

Following the demutualization of the Kuala Lumpur Stock Exchange on 5 January 2004, amendments were made to the securities laws to accommodate the new structure of the exchange, and to enhance the securities regulatory framework and powers of the SC, especially in the area of investor protection. These amendments:

- streamlined and strengthened the framework on investment advice;

- enhanced civil and administrative powers;
• introduced whistleblowing provisions; and
• facilitated regulation and development of the securities laws and to ensure the integrity of the capital markets.

**Enhanced Enforcement Capabilities**

The amendments have clarified and expanded the scope of the powers of the SC to take civil and administrative actions. In addition to the general provision that the SC may take actions against any person who fails to comply, observe, enforce or give effect to the rules of the exchange, clearing house, central depository or provisions in any of the securities laws, the amendments list specific persons who are subject to the SC’s powers. They include, among others, the directors, officers and advisers of listed corporations. Further, the amendments enhance the ability of the SC to require the person in breach to take any such steps as the SC may direct to remedy the breach or mitigate the effect of such breach, including making restitution to the person aggrieved by the breach. The amendments have also expanded the range of situations where the SC may apply to the High Court for certain orders.

**Whistleblowing Provisions**

The whistleblowing provisions were intended to complement enforcement efforts and assist in curbing corporate abuses and promoting better corporate governance. In general, the amendments provide for the reporting of breaches of the law to the relevant authorities and incorporate legal protection to informants for bringing transgressions to light.

In respect of auditors of public-listed corporations, the provisions impose a mandatory obligation to immediately report to the relevant authority, breaches of any securities law, rules of a stock exchange or any matter which may adversely affect to a material extent the financial position of the listed corporation. The SC may also require the auditor to submit any additional material in relation to the audit as the SC may specify, enlarge, or extend the scope of the audit and/or carry out any specific examination or establish any procedure in any particular case. The auditor shall be remunerated for carrying out any orders required by the SC and shall be protected against any legal action in respect of such disclosure.
In practice, merger and acquisition laws are an intricate interplay of various laws and regulations. These laws and regulations are also subject to Malaysian government policy applicable to the particular area of industry where the target company is operating. In short, the regulatory and legal regime governing merger and acquisition activity in Malaysia is relatively fluid and it is always advisable to seek proper professional advice when considering any merger or acquisition in Malaysia.
DISCLAIMER

It should be noted that the material in this book is designed to provide general information only. It is not offered as advice on any particular matter, whether it be legal, procedural or other, and should not be taken as such. The laws and regulations summarized in this book are current as of 17 December 2012. The authors expressly disclaim all liability to any person in respect of the consequences of anything done or omitted to be done wholly or partly in reliance upon the whole or any part of the contents of this book. No reader should act or refrain from acting on the basis of any matter contained in it without seeking specific professional advice on the particular facts and circumstances at issue.
The Philippines is a constitutional democracy with three coequal branches of government, namely, the executive, the legislative and the judicial branches. The Philippines is also a civil law jurisdiction with codified bodies of law. Notable among these are the Corporation Code of the Philippines ("Corporation Code"), that deals with domestic corporations in general, and the Civil Code of the Philippines ("Civil Code"), that embodies general laws relating to obligations and contracts. Decisions of the Supreme Court of the Philippines also have the force and effect of law.

Acquisitions are the most common form of mergers and acquisitions ("M&A") transaction in the Philippines. These acquisitions are generally done through full or partial acquisition of shares or assets of the target company. The Philippines also recognizes the concept of a merger or consolidation. In a merger, the surviving company absorbs a target company. In a consolidation, two or more companies consolidate to form a new corporation. The Philippines does not have specific M&A legislation. Generally, the provisions of the Corporation Code, the Securities Regulation Code ("SRC") and the Civil Code will govern M&A transactions.

The Foreign Investments Act generally governs foreign investments in the Philippines. There are also several pieces of special investment legislation that complement the Foreign Investments Act and help cultivate an investment climate conducive to foreign investment. The Foreign Banks Liberalization Act ("Banks Liberalization Act") and the General Banking Law of 2000 ("General Banking Law") allow foreign banks to conduct full branch operations in the Philippines.
Under this regime:

• foreign exchange controls on virtually all foreign exchange transactions have been lifted;

• a comprehensive build-operate-transfer law allows private sector participation in infrastructure projects that were traditionally undertaken only by the public sector;

• an investors’ lease act allows foreign investors to obtain 50-year land leases in many cases;

• prevailing regulations do not impose quantitative restrictions and a reduction in tariffs for raw materials, intermediate goods and capital equipment, thus making possible the free importation of such goods;

• foreign retailers are allowed to own equity in retail enterprises under specified cases;

• the rates of documentary stamp tax on, among others, transfers and issuances of shares, have generally been reduced, and the number of transactions exempt from this tax have been increased; and

• special economic zones that offer attractive fiscal and non-fiscal incentives to investors pursuant to the Special Economic Zone Act of 1995 are operating in many parts of the country.

The Board of Investments, an agency attached to the Department of Trade and Industry, is the lead agency of the Philippine government in investment promotions. The Board of Investments has a comprehensive promotion program that aims to minimize investment barriers and facilitate the establishment of business ventures throughout the country. The Board of Investments is mandated to draw up an Investment Priorities Plan that includes a list of investment areas or activities that are eligible for fiscal and non-fiscal incentives. On 13 June 2012, President Benigno S. Aquino III signed Memorandum Order No. 40 approving the 2012 Investment Priorities Plan (a copy is attached as Appendix A).

As further demonstration of the government’s thrust of establishing a favorable investment climate for foreign investors, the Supreme Court of the Philippines affirmed the constitutionality and legality of Republic Act No. 7942 (otherwise known as the Mining Law), through a liberal construction of the scope and terms and conditions of financial or technical assistance agreements that foreign investors may enter into with the Philippine government for the exploration, development and utilization of natural resources.
Acquisitions in the Philippines may be structured in one of two ways. The acquiring entity may acquire shares from the shareholders of the target company (share acquisition) or acquire assets directly from the target company (asset acquisition).

The acquiring entity may also proceed to merge with or absorb the target company (merger), with the acquiring entity as the surviving company, or it may consolidate with the target company to form a new company (a consolidation). In a merger, one corporation (the surviving corporation) absorbs another corporation (absorbed corporation). In a consolidation, two or more corporations consolidate to form a new single corporation (consolidated corporation).

Share Purchase Versus Asset Purchase

A share acquisition is procedurally simpler and tends to be more widely utilized than an asset acquisition. A share acquisition basically involves the transfer of shares from the shareholders of the target company to the purchaser. In such transactions, specifically where the purchaser acquires all the outstanding shares of the target company, the purchaser effectively acquires the target company with all its assets and liabilities (including contingent and undisclosed liabilities).

An asset acquisition tends to be more complex because the transaction involves the transfer of various categories of assets and liabilities to the purchaser. Each transfer of a category of assets and liabilities may require different legal treatment and documentation. However, unlike a share acquisition, in an asset acquisition the vendor retains all assets and liabilities not otherwise acquired or assumed by the purchaser.
In asset acquisitions, there is generally no restriction on how the purchase price is allocated among the assets acquired. However, it is prudent to have some basis or justification for the allocation of the purchase price. As a general rule, the purchase price, especially for real property, must not be lower than the fair market value.

Acquisitions Versus Mergers and Consolidations

Mergers and consolidations are procedurally more complicated to effect than either type of acquisition. In a merger or consolidation, all the assets and liabilities of the absorbed corporation or the consolidating corporations are transferred to the surviving corporation or the consolidated corporation, as the case may be. In the case of a merger, the shareholders of the absorbed corporation receive shares of the surviving corporation in exchange for their shares in the absorbed corporation. In a consolidation, the shareholders of the consolidating corporations receive shares in the newly consolidated corporation in exchange for their shares in the consolidating corporations. Thus, both transactions basically involve both the transfer of shares and the transfer of categories of assets and liabilities among the various participants.

Foreign Versus Domestic Investment Considerations

Three forms of business vehicles are recognized in the Philippines: the sole proprietorship, the partnership and the corporation. Of the three, the corporation is generally the most appropriate and the most widely utilized for business purposes. Unlike a sole proprietor and a general partner, who have unlimited liability, the liability of shareholders of a corporation is generally limited to their investment in the corporation.

Foreign investors in the Philippines may utilize any of the following corporate vehicles:

- Joint venture corporation
- Subsidiary
- Branch
- Representative office
A joint venture with Philippine nationals is utilized when a foreign investor wants to invest in partially nationalized businesses. Foreign nationals holding a minority of the shares of a domestic company may negotiate and obtain minority protection. This minority protection is generally contained in shareholders’ agreements or joint venture agreements and, to the extent possible, incorporated in the articles of incorporation and bylaws of the joint venture company.

A foreign investor may incorporate a wholly owned subsidiary to engage in business that is not totally or partially nationalized. A subsidiary is a domestic corporation. It is a legal entity that is separate and distinct from that of its parent company. The requirements to register a domestic corporation also apply to a subsidiary.

A foreign investor may likewise register a branch office to engage in business that is not totally or partially nationalized. A branch is an extension of a foreign company and therefore has no separate and independent legal personality. It carries out the business activities of the head office and earns income in the Philippines. Before a branch may engage in business in the Philippines, the head office must register the branch with the Securities and Exchange Commission (“SEC”).

A representative office deals with the clients of the parent company in the Philippines through information dissemination, promotion and quality control. A representative office does not derive income in the Philippines and is fully subsidized by its head office. The parent company must likewise register the representative office with the SEC before it performs these activities in the Philippines.

In addition to these corporate vehicles, foreign investors may also register a regional headquarters (“RHQ”) or a regional operating headquarters (“ROHQ”) to provide services to their affiliates. An RHQ is an office of a multinational company whose purpose is to act as an administrative branch of a multinational company engaged in international trade and which principally serves as a supervision, communications and coordination center for its subsidiaries, branches or affiliates in the Asia-Pacific region and other foreign markets. An RHQ does not earn or derive income in the Philippines. An ROHQ is an office of a multinational company that is allowed to derive income in the Philippines by performing qualifying services to its affiliates, subsidiaries or branches in the Philippines, in the Asia-Pacific region and in other foreign markets. These qualifying services are:

- general administration and planning;
- business planning and coordination;
- sourcing/procurement of raw materials and components;
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- corporate finance advisory services;
- marketing control and sales promotion;
- training and personnel management;
- logistics services;
- research and development services, and product development;
- technical support and maintenance;
- data processing and communication; and
- business development.
Foreign Investment Restrictions

As a general rule, foreign investors may own up to 100% of a domestic enterprise in the Philippines provided that the domestic enterprise is not engaged in any of the activities listed in the Negative List of the Foreign Investments Act, as amended (see Appendix B: The Ninth Negative List for Foreign Investment in the Philippines, which was approved on 7 November 2012).

There are two Negative Lists: List A and List B. List A contains areas of investment where foreign ownership is limited by mandate of the Philippine Constitution and/or by specific laws. List B contains areas of investment where foreign ownership is limited for reasons of security, defense, risk to health and morals, or protection of local small- and medium-size enterprises. The Negative Lists continue to be further revised. However, amendments to List B cannot be made more than once every two years.

Under the Foreign Investments Act, as a general rule, a domestic market enterprise that is more than 40% foreign-owned must have a paid-in or assigned capital of the Philippine peso equivalent of at least USD200,000. A domestic market enterprise is an enterprise that produces goods for sale, or renders service or otherwise engages in any business in the Philippines. The minimum capitalization requirement of USD200,000 may be reduced to USD100,000 if the activity of the domestic market enterprise involves advanced technology as determined and certified by the Department of Science and Technology, or if it employs at least 50 direct employees as certified by the appropriate regional office of the Department of Labor and Employment.
On the other hand, an export enterprise is not required to comply with this minimum capitalization requirement. An export enterprise is a manufacturer, processor or service entity that exports 60% or more of its output, or a trader that purchases products domestically and exports 60% or more of such purchases.

Anti-Dummy Law

The Philippines has an Anti-Dummy Law that imposes criminal and civil penalties on those violating nationalization laws. The Anti-Dummy Law prohibits foreign nationals from, among other things, intervening in the management, operation, administration or control of a company engaged in a nationalized or partially nationalized activity, whether as an officer or an employee (this prohibition excludes technical personnel specifically authorized by the Secretary of Justice). However, foreign nationals may serve as members of the board or governing body of corporations engaged in partially nationalized activities in a number proportionate to their actual and allowable equity in the company.

Competition Law

There are bills pending in Congress relating to antitrust and monopoly activities but, at time of writing, the Philippines does not have a comprehensive and developed legislation with respect to such activities. There are, however, general laws that are relevant.

The Philippine Constitution outlines the state policy of regulating or prohibiting monopolies when the public interest so requires. No combinations in restraint of trade or unfair competition are to be allowed.

In relation to this policy, the Revised Penal Code of the Philippines penalizes parties entering into any contract or agreement, or taking part in any conspiracy or combination in the form of a trust or otherwise, which restrains trade or commerce. It also penalizes those who prevent, by artificial means, free competition in the market. The code also imposes penalties on parties who monopolize any merchandise or object of trade or commerce, or who combine with any other person or persons to monopolize said merchandise or object in order to alter prices, or who spread false rumors or make use of any other artifice to restrain free competition in the market.
The Civil Code allows the recovery of damages in cases of unfair competition in agricultural, commercial or industrial enterprises. The Price Act identifies illegal acts of price manipulation such as hoarding, profiteering and cartels, while the Consumer Act of the Philippines provides for consumer product quality and safety standards. There are also other laws on unfair competition pertaining to the protection of intellectual property rights.

Exchange Controls

Inbound Investments

As a general rule, foreign exchange may be freely sold and purchased in the Philippines. By way of exception, the Bangko Sentral ng Pilipinas (“BSP”), or the central monetary authority of the Philippines, regulates the purchase and sale of foreign exchange by authorized agent banks (“AABs”), their subsidiary/affiliate foreign exchange corporations (“AAB-forex corps”), non-bank BSP-supervised entities, foreign exchange dealers, money changers and remittance agents (collectively, “BSP Regulated Entities”).

Foreign investments must be registered with the BSP or, in certain instances, with a custodian bank, so that foreign exchange may be sourced from AABs / AAB-forex corps to fund the repatriation of the investment and the remittance of profits and dividends.

If a foreign investment is not registered with the BSP, AABs / AAB-forex corps would not be allowed to sell foreign exchange to fund the repatriation of such investment and the remittance of profits and dividends relating to such investment. However, foreign exchange to fund the repatriation and remittance may be sourced from foreign exchange dealers, money changers and remittance agents.

Outbound Investments

Prior BSP approval for outward investments would be required only if the foreign exchange needed to fund such outward investments would exceed USD60,000,000 (or its equivalent in other foreign currency) per investor per year, and such foreign exchange would be sourced from AABs / AAB-forex corps. Qualified investors may apply to the BSP for a higher annual outward investment limit.

Qualified investors would be insurance and pre-need companies, collective/pooled funds (such as mutual funds, unit investment trust funds and variable insurance), public or private pension or retirement or provident funds, and such other entities and funds that the BSP may determine to be such.
Emergency Powers of the Monetary Board

Foreign exchange transactions are subject to the emergency powers of the Monetary Board of the BSP. In cases of an imminent and actual foreign exchange crisis or national emergency, the Monetary Board, with the approval of the president of the Philippines, may impose restrictions on foreign exchange transactions, such as the temporary suspension or restriction on the sale of foreign exchange by the BSP, subjecting all transactions in gold and foreign exchange to license by the BSP or requiring any foreign exchange obtained by a resident to be delivered to the BSP or any bank or agent designated by the BSP at the effective exchange rate(s).

Securities Law Issues

The introduction of the SRC in 2000 brought about significant changes in securities law in the Philippines. For instance, the new law strengthens the full disclosure approach in public offerings, veering away from the merit system of securities registration. Also, the SRC strengthens the role of the SEC as a market regulator and innovator.

The SEC has also issued new Implementing Rules and Regulations for the SRC (“SRC Rules”). The SRC Rules took effect on 28 February 2004. The new SRC Rules liberalize the requirements for tender offers and enhance corporate governance through expanded disclosure rules and independent director requirements.

Sale, Offer and Distribution in the Philippines

Generally, corporations wishing to sell, offer for sale or distribute securities in the Philippines must first register such securities with the SEC and obtain the corresponding permit to sell.

Securities are shares, participation or interests in a corporation or in a commercial enterprise or profit-making venture and evidenced by a certificate, contract, instrument, whether written or electronic in character. The term securities covers a wide range of contracts that include, among others: investment contracts; certificates of interest or participation in a profit-sharing agreement; certificates of deposit for a future subscription; proprietary or non-proprietary membership certificates; fractional undivided interests in oil, gas or other mineral rights; derivatives, such as options and warrants; and other instruments as may be determined in the future by the SEC.

However, there are “exempt securities” that as a general rule do not require registration. In addition, there are securities sold under “exempt transactions” that are not required to be registered.
Exempt securities generally include securities issued by corporations subject to the supervision and regulation of governmental entities such as the Central Bank, the Insurance Commission or the Housing and Land Use Regulatory Board. Securities issued or guaranteed by the Philippine government, or a foreign government with which the Philippines maintains diplomatic relations, or by any of their political subdivisions and securities issued by a bank are also generally considered exempt securities.

Exempt transactions include one corporation transferring or exchanging its own securities to/with another corporation in connection with a merger or consolidation, and an isolated sale transaction by the owner of securities, where the owner is not the underwriter of the securities. It also includes the sale to fewer than 20 persons in the Philippines, as well as a sale to any qualified buyer as enumerated under the SRC.

Under the SRC Rules, in the case of exempt securities, it is not necessary to provide a written disclosure to the person to whom the securities are offered or to notify the SEC of the offering.

With regard to exempt transactions, the person claiming exemption must provide to all persons to whom the securities are offered, a written disclosure containing specified information. However, it is not necessary to notify the SEC of the offering, except in two kinds of exempt transactions, specifically sale to not more than 19 persons and sale to qualified buyers.

In both the case of sale to not more than 19 persons and sale to qualified buyers, formal notice to the SEC is required. Failure to file this notice will subject the person claiming exemption to sanctions under the SRC and may give rise to the presumption that the exemption is not available.

The SEC may add to the class of exempt securities and exempt transactions if it finds that the enforcement of the SRC with respect to such securities and transactions is not necessary in the public interest and for the protection of investors.

The Philippines allows the use of “uncertificated securities” for corporations with registered securities or those listed in a securities exchange. Uncertificated securities are securities evidenced by electronic or similar records. These are transferred and pledged in the same manner as ordinary securities. For a transfer of an uncertificated share to be valid on the part of the corporation, the transfer must be recorded in the corporation’s books to show the names of the parties and the number of shares transferred.
Issuance or Sale of Securities Abroad
The SRC requirement for registration of securities is directed at the sale, or the offer for sale, of securities to the public within the Philippines. Hence, if a sale or offer of securities is not made in the Philippines, the securities need not be registered with the SEC.

Specific Industry Regulation
Most M&As in the Philippines do not require special statutory or regulatory consent or approval. General laws, including the Corporation Code and the Civil Code, largely govern such activities. In most cases, the parties only need to obtain corporate approvals to authorize the merger or acquisition and comply with rules and regulations to administratively and procedurally execute and implement the transaction. However, special regulations do apply in cases of M&A in certain regulated industries such as banking, insurance and telecommunications.

Banking Sector
Bank mergers and consolidations are subject to the approval of the BSP. Merging or consolidating banks should consult with the BSP prior to the finalization of any merger or consolidation agreement.

BSP policies tend to encourage and promote mergers and consolidations in the banking sector as a means to develop larger and stronger financial constitutions. Most notable of these policies is the grant of fiscal and non-fiscal incentives to merging or consolidating banks and other financial intermediaries. These incentives include the allowance of revaluation of bank premises, improvements and bank equipment, and the restructuring of payment of past due obligations of the constituent banks with the BSP over a period not exceeding 10 years.

Subject to the approval of the BSP, the incentives may also be granted in cases of share acquisitions.

A foreign bank may now own up to 100% of the voting stock in one domestic bank through the purchase of the domestic bank’s stock under the General Banking Law. Up to June 2007 and subject to certain guidelines, the Monetary Board could authorize a foreign bank to acquire up to 100% of the voting stock of one bank organized under the laws of the Philippines.
Within the same period, the Monetary Board could authorize any foreign bank which, prior to the General Banking Law coming into effect, was able to acquire up to 60% of the voting stock of a bank (under the Banks Liberalization Act and the Thrift Banks Act of 1995) to further acquire voting shares to the extent necessary for it to own 100% of the voting stock of the bank.

Since June 2007, a foreign bank may operate in the Philippines by acquiring up to 60% of the voting stock of an existing domestic bank. The citizenship of the corporation that owns shares in a bank will follow the citizenship of the controlling stockholders of said corporation, irrespective of the place of its incorporation.

**Insurance Sector**

Pursuant to circulars issued by the Insurance Commission, all insurance companies must obtain the prior approval of the Insurance Commission before effecting any change in ownership.

For mergers and consolidations, the Insurance Code provides that, upon prior notice to the Insurance Commissioner, two or more domestic insurance companies may merge into a single corporation. This can be one of the constituent corporations or a single new corporation formed by the consolidation.

The Insurance Code further provides that upon receipt from the SEC of the certificate of merger or of consolidation, the constituent companies shall surrender to the Insurance Commissioner their respective certificates of authority to transact insurance business. The absorbing or surviving company in case of merger, or the newly formed company in case of consolidation, shall immediately file with the Insurance Commissioner the corresponding application for issuance of a new certificate of authority to transact insurance business, together with a certified copy of the certificate of merger or of consolidation issued by the SEC.

In addition to the requirement of prior notice to the Insurance Commissioner of a proposed merger or consolidation of two or more domestic insurance companies, current regulations and policy of the Insurance Commission requires its prior approval for mergers and consolidations.
Telecommunications Sector

In the telecommunications sector, the requirements of the Public Service Law are relevant. In the case of a share acquisition, the approval of the National Telecommunications Commission (“NTC”) is required if the transfer or sale of shares in a telecommunications company will result in the purchaser owning more than 40% of the subscribed capital stock of the telecommunications company.

In relation to mergers and asset acquisitions, the Public Service Law requires the prior approval of the NTC for the sale, alienation, mortgage, encumbrance or lease of property, franchises, certificates, privileges or rights; or the merger or consolidation of property, franchises, privileges or rights of a telecommunications company.
In addition to the relevant regulatory consents and approvals, corporate authorizations, contractual consents and contractual approvals should also be noted.

Typical restrictions on transfer or issuance of shares include rights of first refusal over the shares to be purchased, or preemptive rights of other shareholders if the shares to be acquired are shares to be issued from unissued authorized capital stock or shares to be issued from an increase in the authorized capital stock of the target company. In this regard, the articles of incorporation, bylaws of the target company and any shareholders’ agreements must be reviewed and examined carefully by a prospective purchaser.

Loan agreements and other contracts relating to material commitments of the target company will also typically contain change of control provisions, in which case either the consent of the lenders or the appropriate counterpart is required for a merger or acquisition that will result in a change in control of the target company.

The Corporation Code also has specific shareholders’ vote requirements to authorize mergers and consolidations. In the case of a merger or consolidation, once the transaction has received majority vote consent from the boards of directors or trustees of all the companies that are party to the transaction, such a transaction must be approved by the shareholders or members.
The shareholders of all of the involved companies shall be given at least two weeks’ notice of a general meeting of shareholders. This notice should also inform them as to the purpose of the general meeting of shareholders and include a summary of the plan for the merger or consolidation. An affirmative vote of stockholders representing at least two-thirds of the outstanding capital stock of the company (or at least two-thirds of the members in cases involving non-stock companies) is needed to approve the plan.

Any amendment to the plan for the merger or consolidation must similarly be approved by a majority vote from the board of directors and an affirmative vote from stockholders representing at least two-thirds of the company’s outstanding capital stock.

The articles of incorporation and bylaws of certain companies may impose higher voting requirements in the board of directors’ and/or shareholders’ level for mergers and consolidations as against those imposed by the Corporation Code. As these higher voting requirements are generally recognized as valid, a prospective party to a merger or consolidation must likewise review these documents carefully.
Jurisdictional Tax

Effective 1 January 2009, domestic corporations are subject to 30% corporate income tax on net income from all sources, i.e., within or without the Philippines. Certain classes of income of a domestic corporation are subject to different tax treatments. For example, interest on peso deposits, yield from peso deposit substitutes and trust funds, as well as royalties from Philippine sources received by a domestic corporation, are subject to a final withholding tax of 20%, while dividend income from another domestic corporation is exempt from income tax. However, interest income derived by a domestic corporation from a depositary bank under the expanded foreign currency deposit system is subject to a final income tax of 7.5% of such interest income.

Dividends

Dividends received by a resident foreign corporation from a domestic corporation are not subject to tax. Dividends from a domestic corporation to a non-resident foreign corporation are generally subject to a final withholding tax of 30%. However, a lower rate of 15% may apply, subject to the condition that the country in which the non-resident foreign corporation is domiciled allows a credit against the tax due from the non-resident foreign corporation, taxes deemed to have been paid in the Philippines equivalent to 15%, which represents the difference between the regular income tax of 30% and the 15% tax on dividends. Philippine tax treaties may also provide for a lower tax rate on dividends.
Branch Profits
Generally, branch profit remittances by a resident foreign corporation are subject to a 15% final withholding tax. The tax is based on the total profits applied or earmarked for remittance without any deduction for the tax component.

Tax Treaties
The tax on interest, royalties and dividends, among others, may be reduced pursuant to applicable tax treaties. To date, the Philippines has existing tax treaties with: Australia, Austria, Bahrain, Bangladesh, Belgium, Brazil, Canada, China, the Czech Republic, Denmark, Finland, France, Germany, Hungary, India, Indonesia, Israel, Italy, Japan, South Korea, Malaysia, the Netherlands, New Zealand, Norway, Pakistan, Poland, Romania, Russia, Singapore, Spain, Sweden, Switzerland, Thailand, United Arab Emirates, the United Kingdom, the United States and Vietnam.

Share Acquisitions Versus Asset Acquisitions Versus Mergers
In share acquisitions, the target company will retain the same tax basis for its assets regardless of the purchase price paid for its shares by the purchaser. In asset acquisitions, the purchaser’s tax basis is generally equivalent to the purchase price of the acquired assets.

In a merger, the tax basis of the assets received by the surviving corporation is the tax basis such assets would have had in the hands of the absorbed corporation, i.e., historical cost, increased by the amount of gain recognized by the absorbed corporation on the transfer. However, the tax basis of the shares of the surviving corporation received by the shareholders of the absorbed corporation will be the same as the tax basis of the absorbed corporation’s property, stocks or securities surrendered in exchange for the surviving corporation’s shares, decreased by the money received and fair market value of the other property received and increased by the amount treated as dividend of the shareholder and the amount of any gain that was recognized in the exchange.

The Tax Code recognizes instances of tax-free transfers of properties by a corporation in exchange for shares of stock of another corporation. Upon compliance with the requirements, a merger or consolidation can qualify as a tax-free exchange or corporate reorganization. Further, under a recent law, a merger or consolidation that meets the requirements of the Tax Code is exempt from documentary stamp tax in respect of any real property transferred pursuant to the merger or consolidation. The original issuance of shares of stock under a plan of merger or consolidation (e.g., issuance of additional shares out of an increase in
authorized capital stock of the surviving corporation) will, however, remain subject
to documentary stamp tax at the rate of PHP1 for every PHP200 or fractional
part (effectively 0.5%) of the total par value of the shares of stock issued. The
Documentary Stamp Tax ("DST") on the original issuance of shares of stock is
payable by the issuing corporation.

In a merger, if the liabilities transferred to, or assumed by, the surviving
corporation exceed the total of the basis of the property transferred by the
absorbed corporation, the excess shall be considered a taxable gain of the
absorbed corporation.

**Net Operating Loss Carryover**

The net operating loss of a business or enterprise for any taxable year
immediately preceding the current taxable year, which has not been previously
deducted from gross income, is carried over as deduction from gross income
for the next three consecutive taxable years immediately following the year of
such loss. A net loss incurred in a taxable year during which the taxpayer was
exempt from income tax shall not be allowed as a deduction from gross income
of succeeding years.

Net operating loss carryover is not allowed if there has been a substantial change
in the ownership of the target company. There is no substantial change in the
ownership of the target company if:

- 75% or more (in nominal value) of the outstanding issued shares are held by
  or on behalf of the same persons; or
- 75% or more of the paid-up capital of the corporation is held by or on behalf
  of the same persons.

**Transactional Tax**

**Documentary Stamp Tax**

A recent law amended the Tax Code to reduce DST rates on certain commercial
transactions. The same law also expanded the number of transactions exempt
from DST. In share acquisitions, a DST of PHP0.75 on each PHP200 (or fraction
thereof) of the par value of the shares transferred is imposed on the transfer of
the shares.

In asset acquisitions, the applicable DST on deeds of sale or conveyance of real
property is PHP15 for:

- consideration or value received or contracted to be paid for such realty that
does not exceed PHP1,000; and
• each additional PHP1,000 in excess of the PHP1,000, of the consideration or fair market value of the real property (whichever is higher).

The DST imposed on mortgages and pledges is PHP20 for the initial PHP5,000 of the amount secured, and an additional tax of PHP10 on each PHP5,000 (or fraction thereof) in excess of the first PHP5,000.

The DST on leases of real properties is PHP3 for the first PHP2,000 (or fraction thereof) and an additional PHP1 for every PHP1,000 (or fraction thereof) in excess of the first PHP2,000 of the rent for each year of the term of the lease.

The DST on the issuance of certificates of indebtedness is PHP1 on each PHP200 (or fraction thereof) of the face value of such documents.

As a general rule, DST is also payable on the assignment or transfer of any mortgage, pledge, lease or certificate of indebtedness, at the same rate as that imposed on the original instrument. However, if there is no change in the maturity date or remaining period of coverage from that of the original instrument, the assignment or transfer of the mortgage, pledge, lease or certificate of indebtedness is exempt from DST.

In mergers, the issuance of shares by the surviving corporation is subject to a DST of PHP1 on each PHP200 (or fraction thereof) of the par value of the shares. However, transfers of stock or real property pursuant to the merger are exempt from DST, provided the requirements of the Tax Code are met.

Finally, sales or exchanges of shares of stock listed and traded in the Philippine Stock Exchange ("PSE") are exempt from DST.

Capital Gains Tax and Corporate Income Tax

In share acquisitions, a capital gains tax ("CGT") of 5% on any gain not exceeding PHP100,000 and 10% on any gain that exceeds PHP100,000 is imposed on the gain (i.e., selling price or book value, whichever is higher, less acquisition cost) on the sale of shares of domestic corporations that are not sold or disposed of through the PSE.

The final tax is imposed on the net capital gains realized by the taxpayer during the taxable year from the covered transactions.

In the recently issued Revenue Regulations No. 6-2008: Consolidated Regulations on the Taxation of the Sale, Barter, Exchange or Other Disposition of Shares of Stock Held as Capital Assets, the term capital gains was defined as the excess of the amount realized from the sale or other disposition of shares of stock (i.e., the sum of money and/or the fair market value of non-cash property received, if any) over the basis or adjusted basis of the shares.
In determining the selling price and cost basis for purposes of calculating capital gains in accordance with the preceding rule, Revenue Regulations 6-2008 reiterated the prevailing rules appearing in the Tax Code and existing regulations. However, in Section 7 of Revenue Regulations 6-2008, the Bureau of Internal Revenue ("BIR") declares that, if the fair market value of the shares of stock sold, bartered or exchanged is greater than the amount of money and/or fair market value of the property received, the excess of the fair market value of the shares of stock sold, bartered or exchanged over the amount of money and the fair market value of the property, if any, received as consideration shall be deemed a gift subject to the donor’s tax under the Tax Code.¹

Nevertheless, CGT on the transfer of shares may be avoided under applicable treaty provisions. A BIR ruling is required to confirm tax treaty relief. If the shares transferred are listed and traded through the PSE, the transfer is subject to a tax of 0.5% of the gross selling price.

In an asset acquisition, the income from the sale of capital and non-capital assets other than land and buildings is generally taxable as part of ordinary corporate income at the rate of 30%. A final tax of 6% is imposed on the gain presumed to be realized on the sale of land and/or buildings that are not actually used in the business of the corporation and are treated as capital assets.

In a merger, exchanges of property of the absorbed corporation solely for stock of the surviving corporation and the surrender by shareholders of the absorbed corporation of their shares in the absorbed corporation for shares of the surviving corporation is tax free.

Value Added Tax

The value added tax ("VAT") is a form of sales tax imposed on the sale of goods and rendition of services in the Philippines, or the importation of goods into the Philippines. VAT is included in the amount paid by the buyer for the purchase of the goods, properties or services, but the amount of VAT must be shown as a separate item in the invoice or receipt. VAT is based on the gross selling price of the goods or properties sold. It is an indirect tax that may be passed on to the buyer.

Under Section 99 of the Tax Code, donor’s tax is generally levied at rates ranging from 2%-15%. However, if the parties to the donation are "strangers" (e.g., donations involving natural persons who are not relatives by consanguinity in the collateral line within the fourth degree or those involving juridical persons), the applicable donor’s tax rate is 30%.

¹ Under Section 99 of the Tax Code, donor’s tax is generally levied at rates ranging from 2%-15%. However, if the parties to the donation are "strangers" (e.g., donations involving natural persons who are not relatives by consanguinity in the collateral line within the fourth degree or those involving juridical persons), the applicable donor’s tax rate is 30%.
ranging from 2%-15%. However, if the parties to the donation are “strangers” (e.g., donations involving natural persons who are not relatives by consanguinity in the collateral line within the fourth degree or those involving juridical persons), the applicable donor’s tax rate is 30%. purchaser. However, the VAT-registered purchaser may apply or deduct the VAT passed on to it by the VAT-registered seller (“input VAT”), against the VAT liability of the purchaser (“output VAT”).

VAT is usually collected through the tax credit method where each firm applies the tax rate to its taxable sales but is allowed a credit for VAT paid on its purchases of goods and services for business use, including the tax paid on purchases of capital equipment.

There is no VAT on a normal share acquisition. The transfer of the assets of absorbed corporations to another corporation pursuant to a merger is not subject to VAT. In mergers or consolidation of corporations, the surviving corporation shall absorb any unused input tax of the dissolved corporation as of the date of merger.

In relation to asset acquisitions, VAT is due on the sale of goods or properties originally intended for sale or for use in the ordinary course of business that are sold not in the course of normal business. Similarly, a transaction deemed a sale not in the course of business is subject to VAT. However, the sale of real properties not primarily held for sale to customers or for lease in the ordinary course of trade or business is not subject to VAT.

Note that under BIR Revenue Regulations No. 4-2007, even if the real properties are not primarily held for sale to customers or for lease in the ordinary course of trade or business, but the real properties are used in the trade or business of the seller, the sale thereof shall be subject to VAT, on the grounds that the transaction is incidental to the taxpayer’s main business.2

The transfer of property pursuant to a statutory merger will be exempt from VAT. Any unused input tax credits of the absorbed corporation as of the effective date of the merger shall be absorbed and can be utilized by the surviving corporation moving forward.

Note, however, that in transfers or exchanges of real property for shares of stock in a Real Estate Investment Trust falling under Section 40 (C) (2) of the Tax Code, the transferor is subject to VAT on the transfer of property classified as ordinary

2 We believe that the provision of Revenue Regulations No. 4-2007 that imposes VAT on the sale of real properties used in trade or business (but not primarily held for sale or for lease) is legally untenable, because the Tax Code itself imposes VAT only on the sale of real property primarily held for sale or for lease to customers.
asset based on the fair market value of the property transferred. “Real Estate Investment Trust” or “REIT” is a stock corporation established in accordance with the Corporation Code of the Philippines and the rules and regulations promulgated by the Commission principally for the purpose of owning income-generating real estate assets.

Other issues
In relation to asset acquisitions, provinces and cities may impose local transfer taxes and registration fees (with the register of deeds) in cases involving the transfer of real property ownership.

Provinces may levy a tax on the transfer of real property ownership at a rate not exceeding 0.5% based on the total consideration involved in the acquisition of the property or the fair market value of the property, whichever is higher.

The real property transfer tax rate that cities can levy may exceed the maximum rate allowed for provinces but by no more than 50%.
In the Philippines, employment issues tend to be policy sensitive. The Philippines recognizes and guarantees the employees’ right to security of tenure and to form organizations for their collective benefit and welfare. Employees’ right to security of tenure means that they can be removed from their jobs only for one of the specified just and authorized causes and after the observance of procedural due process defined by law. In cases of valid removals, severance payments may be required, depending on the cause of the removal.

Share Acquisitions

In cases of share acquisitions, there are no associated employment-related issues. The acquirer merely buys the shares of the target company and the underlying employment relationship between the target company and its employees is unlikely to be affected.

Asset Acquisitions

In an asset acquisition, the legal consequences under Philippine labor laws are more complex and uncertain. Although there are no defined statutes governing employment matters in asset acquisitions, case law provides certain guidelines that illustrate the judicial treatment of employment-related conflict that may arise out of an asset acquisition.
Under Philippine case law, the general rule is that labor contracts are considered personal contracts, i.e., enforceable only against the parties to the contract. Because of this personal nature, unless expressly assumed, labor contracts are not enforceable against a purchaser of a business or assets. The purchaser in good faith has no obligation to absorb employees of the vendor or to continue employing them. However, this general rule is not absolute. In certain cases, the Philippine Supreme Court has been known to disregard the personal nature of labor contracts and hold either the purchaser, the vendor, or both, liable in transactions deemed not to have occurred in good faith.

Mergers and Consolidations

In cases of mergers and consolidations, the rules on transfer of general liabilities and obligations to the surviving corporation or the consolidated corporation, as the case may be, are applied to employment-related obligations and liabilities. The surviving or consolidated corporation is made responsible and liable for all the liabilities and obligations of each of the constituent corporations in the same manner as if such surviving or consolidated corporation had itself incurred such liabilities or obligations. Any claim, action or proceeding pending by or against any such constituent corporations may be prosecuted by or against the surviving or consolidated corporation, as the case may be.
Preliminary Agreement - Memorandum of Understanding/ Letter of Intent

There is no legal requirement under Philippine law for a preliminary agreement, memorandum of understanding (“MOU”) or a letter of intent prior to commencing preliminary transactions among parties to a negotiated acquisition. The need for such preliminary agreement largely depends upon the requirements and the convenience of the parties. However, it is not unusual for the parties to a negotiated acquisition to enter into an MOU or a letter of intent covering the broad parameters of the acquisition, obligations of confidentiality, as well as “no-shop” obligations on the part of the prospective vendor. Such preliminary agreements may be made non-binding, partially binding or totally binding.

Philippine law recognizes the contract of option. A contract of option is a binding and enforceable contract. In a contract of option, the seller, for a consideration distinct from the purchase price, grants the purchaser the exclusive option to purchase specific assets for a certain price within the period of the option.

Due Diligence

The general rule in the Philippines is caveat emptor or buyer beware (see box: A Due Diligence Checklist for the Philippines), unless the vendor contractually represents and warrants certain matters that are subject to indemnification in case of breach. Because of this, due diligence investigations remain a critical part of mergers and acquisitions in the Philippines. Additionally, Philippine law
imposes the duty of diligence on directors of corporations. As a result, directors are duty bound to properly inform themselves as regards the target company and its assets and liabilities. As a general rule, Philippine law will not protect a person against his or her own negligence regardless of whether such negligence was merely a contributory or the proximate cause of its own injury.

**A Due Diligence Checklist for the Philippines**

At the outset, the purchaser and its lawyers will have to agree on the scope of the legal due diligence. A comprehensive legal due diligence in the Philippines will cover:

- corporate organization and ownership;
- financial aspects (normally in coordination with the purchaser’s accountants or financial consultants);
- foreign investment regulations;
- government regulation;
- taxation (normally in coordination with the purchaser’s accountants);
- employment matters;
- property;
- business and operational matters;
- contracts;
- intellectual property;
- legal proceedings, disputes and investigations;
- insurance policies; and
- environmental matters.

Unless the prospective purchaser is an insider and is aware of the business of the target company, a due diligence is imperative in almost all mergers and acquisitions. However, to a certain degree, a prospective purchaser of shares of a public company will have a degree of awareness of the operations of the issuer and its assets and liabilities because public companies have continuing disclosure obligations to the public.
Because the purchaser assumes all the assets and liabilities of the target company in a share acquisition, the due diligence investigation for a share acquisition is relatively more extensive than in the case of an asset acquisition. Due diligence investigation in a merger or consolidation is also necessarily extensive.

To substantiate matters represented by the seller to the purchaser, due diligence investigations will typically involve searches of public records. Typically, corporate searches are conducted in the records of the SEC.

In relation to title searches, the Philippines does not have title registry for personal property. However, the Philippines follows the Torrens system in relation to land registration and land titles are normally easily verifiable with the register of deeds. Certain agreements creating or transferring real rights over property must also be registered and recorded in certain registries such as the real estate mortgage registry for real estate mortgages and the chattel mortgage registry for chattel mortgages.

Documentation and Agreements

Should the prospective purchaser decide to continue with the acquisition after due diligence investigations, the legal documentation will have to be drafted. Typically, the purchaser’s lawyers prepare the initial drafts.

Share Acquisitions

There is no legal document required for the validity of the transfer of shares of a corporation. The vendor’s delivery of the duly endorsed share certificates is sufficient to transfer the ownership of the shares from the vendor to the purchaser. However, the transfer of shares will not be recognized or valid as far as the target company and third parties are concerned, unless the transfer is recorded in the stock and transfer book of the target company. Certain documentation will be required to comply with this procedural requirement.

The documentation, whether all or some of the shares of the target company are purchased, will normally include a share purchase agreement and a simple deed of assignment for the shares. The latter is made for convenience and ease of presentation of the transfer document to the tax authorities.

If the share acquisition is only partial, the legal documentation will also normally include a joint venture agreement or a shareholders’ agreement between the purchaser and the other (remaining) shareholders of the target company. If the purchaser will provide technical or other services to the target company, a technical services agreement or similar agreement may also be executed.
Asset Acquisitions

Legal documentation for an asset acquisition tends to be more complicated than documentation for a share acquisition because the former involves the transfer of different categories of property. Different categories of property will often require the preparation of different transfer documents.

In an asset acquisition, there is typically an asset purchase agreement assigning the assets purchased in broad terms. However, there are also various deeds of assignments for specific property such as shares of stock, real property and motor vehicles. Key personnel of the target company may also execute employment agreements with the purchaser if the assets or business are bought as a going concern.

Mergers and Consolidations

In merger or consolidation transactions, in addition to the legal documentation for the transfer or exchange of shares and property between or among the corporations, the constituent corporations must prepare and approve a plan of merger or consolidation. The plan of merger or consolidation will state the terms of the merger or consolidation, the mode of carrying out the merger or consolidation and the changes to be made to the articles of incorporation of the surviving corporation or the consolidated corporation, as the case may be. The plan of merger or consolidation must be submitted to the SEC for approval. In cases where the corporations involved are under regulation or supervision by specific regulatory agencies, the favorable recommendation of the regulatory agency concerned must also be obtained.

To confirm that the merger or consolidation is tax exempt, a formal application must also be filed with the BIR.

Representations and Warranties

Representations and warranties in share acquisitions tend to be more extensive than in asset acquisitions because in the former, the purchaser generally acquires the target company with all its assets and liabilities whether known or unknown, actual, accrued or contingent. The vendor, if asked to make representations and warranties, will more often than not either disclose information or want to limit its liabilities in case of breach.
Under Philippine law, non-disclosure of facts is generally not in itself fraudulent unless there is a duty to reveal such facts. Usual exaggerations in trade are also not in themselves fraudulent if the other party (the purchaser) had an opportunity to know the facts. Misrepresentation made in good faith is not necessarily fraudulent but may constitute error.

**Provisions for Inclusion in an Acquisition Agreement**

A typical acquisition agreement will normally cover:

- object of the purchase and sale;
- agreement to buy and sell;
- purchase price;
- representations and warranties;
- closing conditions, obligations and procedures;
- post-closing procedures;
- covenants and undertakings;
- confidentiality and non-competition;
- costs and expenses;
- indemnity;
- further assurances;
- dispute resolution;
- governing law and venue; and
- schedules, which may include the forms of the specific transfer documents required.

**Completion**

The completion or closing requirements will depend on the mode of acquisition. However, completion is, almost without exception, subject to the condition that all government approvals and non-regulatory consents and approvals have been obtained.

In cases of share acquisitions, typical completion or closing requirements include the delivery of the duly endorsed share certificates representing the shares purchased and the recording of the transfer of the shares from the vendor to
the purchaser in the stock and transfer book of the target company. The latter closing requirement means the purchaser is recognized as a shareholder of the target company. However, the recording may pose some timing problems because the corporate secretary of the target company will not record the transfer of the shares unless all taxes on the transfer of shares are paid and a BIR clearance is obtained. The vendor will not normally be willing to advance the amount of taxes and will normally prefer to apply part of the purchase price to the payment of the taxes. The payment of taxes and the issuance of the BIR clearance may take one to two weeks.

However, if the transaction involves filing an application for tax treaty relief from the BIR to confirm that the sale of shares of stock is exempt from capital gains tax under the relevant Philippine tax treaty, the application process may take around one to two months to complete. This invariably becomes a negotiated closing condition. In cases of asset acquisitions, closing conditions will typically include delivery of the evidence of title of the asset purchased and various deeds of assignments for specific property such as shares of stock, real property and motor vehicles. Employment agreements may also be executed for key personnel of the target company if the assets or business is bought as a going concern. In cases involving acquisition of real property, a certificate of authority to register from the BIR is normally required. If the transaction involves a merger or consolidation, an application for a ruling or certification to confirm that the asset transfer is tax exempt will also have to be filed with the BIR. The application process normally takes around three to six months to complete.
Acquisition of a Substantial Shareholding

Generally, a purchaser who acquires directly or indirectly the beneficial ownership of more than 5% of any class of equity security of a public company is required to disclose the acquisition to the:

- public company;
- SEC; and
- PSE, if the equity security is listed.

This disclosure should take place within five business days after the date of acquisition of direct or indirect beneficial ownership.

Thereafter, the purchaser is required to file regular reports in prescribed forms with the SEC and the PSE (if the equity security is listed) indicating any change in the beneficial ownership of the equity security.

A public company under this section pertains to:

- an issuer whose securities are registered with the SEC;
- an issuer whose securities are listed for trading in the PSE; or
- an issuer with assets of at least PHP50 million or such other amount as the SEC shall prescribe, and that has 200 or more holders, each holding at least 100 shares.
The coverage of what is considered beneficial ownership for purposes of the foregoing rules on disclosure is quite broad. Under the SRC Rules, a beneficial owner includes:

- any person who, directly or indirectly, through any contract, arrangement, understanding, or relationship, or otherwise has or shares:
  - voting power, including the power to direct the voting of the security; and/or
  - investment power, including the power to dispose or to direct the disposition of the security;

- any person who has the right to acquire beneficial ownership within 30 days including the right to acquire:
  - through the exercise of any option, warrant or right;
  - through conversion of any security;
  - pursuant to a power to revoke a trust, discretionary account or similar arrangement; or
  - pursuant to an automatic termination of a trust, discretionary account or similar arrangement.

A person shall be deemed to have an indirect beneficial ownership in any security that is:

- held by members of his or her immediate family sharing the same household;
- held by a partnership to which he or she is a general partner;
- held by a corporation of which he or she is a controlling shareholder; or
- subject to any contract, arrangement or understanding that gives him or her voting or investment power with respect to such securities. However, a broker dealer, investment house, bank, insurance company, investment company or a pension plan shall not be deemed to be beneficial owners of securities held by them for the benefit of third parties or in customer or fiduciary accounts in the course of business, so long as the shares were acquired by such persons or institutions without the purpose or effect of changing or influencing the control of the issuer.
Insider Dealing

A purchaser should also be generally aware of insider trading issues relating to the acquisition of securities of public companies.

**Definitions of Insider Dealing**

Insiders can be classified in three categories:

**Corporate insiders** - such as the public company; and the directors or officers of (or persons performing similar functions), or persons controlling, controlled by or under common control with, the public company.

**Temporary insiders** - such as a person whose relationship or former relationship to the public company gives or gave him or her access to material information, about the public company or the security, that is generally not available to the public. This category includes underwriters, lawyers, accountants and consultants.

**Tippers and tippees** - such as a person who learns such information by a communication from any of the foregoing insiders; and a government employee, director or officer of an exchange, clearing agency and/or self-regulatory organization who has access to material information about an issuer or a security that is not generally available to the public.

Under the SRC, information is "material non-public" information if it has not been generally disclosed to the public and would likely affect the market price of the security after being made known to the public and the lapse of a reasonable time for the market to absorb the information; or a reasonable person would consider the information important under the circumstances in determining whether to buy, sell or hold on to a security.

Under the SRC, it is unlawful for an insider to sell or buy the securities of the public company, if he or she is in possession of material information that is not generally available to the public (see box: Definitions of Insider Dealing) with respect to the public company or the security, unless:

- the insider proves that the information was not gained from such relationship; or
- if the other party selling to or buying from the insider (or his or her agent) is identified, the insider proves that:
  - he or she disclosed the information to the other party; or
  - he or she had reason to believe that the other party is in possession of the information.
It is also unlawful for any insider to communicate material non-public information about the issuer or the security to any person, where the insider communicating the information knows or has reason to believe that such person will likely buy or sell a security of the issuer while in possession of such information.

It is presumed that a purchase or sale of a security by an insider or his or her spouse or relatives by affinity or consanguinity, legitimate or common-law, shall have been effected while in possession of material non-public information if transacted after such information came into existence prior to the dissemination of such information to the public and the lapse of a reasonable time for the market to absorb such information. This presumption shall be rebutted upon the purchaser or seller showing that he or she was not aware of the material non-public information at the time of the purchase or sale.

Under the PSE rules, an unusual trading activity involving an issuer’s securities that occurs without any apparent reason gives rise to the presumption that there is insider trading or a rumor or a report, whether true or false, about the issuer. The issuer must respond promptly to any inquiry by the PSE regarding the unusual trading activity.

Takeovers Code

The Philippines does not have a takeovers code dealing with takeovers of public companies. However, the SRC provides for stringent rules for tender offers to protect minority shareholders whose shares are often not taken up by a takeover group. Moreover, the SEC promulgated implementing rules and regulations regarding tender offers for any class of equity securities (except non-voting shares) of public companies.

The term tender offer means a publicly announced intention by a person acting alone or in concert with other persons to acquire equity securities of a public company.

The tender offer rules seek to establish standards for the dissemination of a tender offer and for the pro-rating of an acquisition in the event that the securities tendered are more than the number desired by the purchaser. The tender offer rules also seek to protect the shareholders of public companies by ensuring equal access to the tender offer and fair treatment of all shareholders who wish to tender their securities.
This pro-rating takes effect should the tender offer be for less than all the securities of a class and if the number of securities tendered is greater than the number the purchaser is bound or willing to take up and pay for. In this case, the securities tendered shall be taken up and paid for by the purchaser on a pro-rata basis, according to the number of securities tendered by each security holder.

**Mandatory Tender Offers**

Under the SRC Rules, a purchaser is required to make a tender offer for equity of shares of a public company in an amount equal to the number of shares that the person intends to acquire in any of the following circumstances:

- The purchaser intends to acquire 35% or more of the equity shares within a period of 12 months.
- If the acquisition would result in ownership of more than 51% of the equity shares of a public company.

A purchaser is exempted from the requirement to make a mandatory tender offer in any of the following circumstances:

- Purchase of newly issued shares from unissued capital stock, provided the acquisition will not result to a 50% or more ownership of the shares by the purchaser.
- Any purchase of shares from an increase in authorized capital stock
- In connection with foreclosure proceeding involving a duly constituted pledge or security arrangement where the acquisition is made by the debtor or creditor
- Purchases in connection with privatization undertaken by the government of the Philippines
- Purchases in connection with corporate rehabilitation under court supervision
- Purchases through the open market at the prevailing market price
- Merger or consolidation

Purchasers exempt from mandatory tender offer are nonetheless required to comply with disclosure requirements and other obligations imposed by the SRC.

The mandatory tender offer applies even if the acquisition is not intended to acquire control over the public company. The intention to acquire the shares, as a record or beneficial owner, is sufficient to trigger the thresholds.

In addition, the SEC does not distinguish between direct and indirect acquisitions of the 35% of the equity shares in a public company in applying the tender offer.
thresholds. Thus, even if the acquisition of the 35% equity of the target company is achieved by means of the acquisition of the shares of a holding company that owns the shares of the target company, the mandatory tender offer rules apply.

Announcements of Tender Offer

A purchaser making a tender offer shall make a public announcement of his or her intention, prior to the commencement of the offer. However, such announcement shall not be made until the purchaser has the resources to implement the offer in full.

A purchaser wishing to make a tender offer for a class of securities of a public company is required to file a tender offer statement together with the tender offer materials with the SEC, the public company and the PSE (if the equity securities are listed), at least two business days prior to the commencement of the tender offer.

The tender offer report contains, among other items, the purpose of the tender offer and the plans or proposals of the purchaser relating to extraordinary corporate transactions such as a merger, reorganization or liquidation involving the public company or any of its subsidiaries.

On the commencement date of the tender offer and for two consecutive days thereafter, the purchaser is also required to publish, send or give the tender offer to the security holders by complying fully with either of two methods of dissemination of the tender offer: long-form publication or summary publication (see box: Methods for Publicizing a Tender Offer).

If a person becomes aware of a potential tender offer before such offer has been publicly announced, that person may not buy or sell, directly or indirectly, the securities of the public company that is the target of the potential tender offer until the tender offer is publicly announced. Such buying or selling constitutes insider trading under the SRC.

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<tr>
<th>Methods for Publicizing Tender Offers</th>
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<tr>
<td>On the commencement date of a tender offer and for two consecutive days thereafter, the purchaser must publicize in two newspapers of general circulation in the Philippines, the offer to security holders through:</td>
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<tr>
<td><strong>Long-form publication</strong> - the purchaser publishes all the information required in the tender offer report filed with the SEC; or</td>
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<tr>
<td><strong>Summary publication</strong> - the purchaser publishes certain information included in the tender offer report filed with the SEC and furnishes any security holder, upon request, a copy of the tender offer report filed with the SEC.</td>
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Timetable

Unless withdrawn, a tender offer must remain open for at least 20 business days from its commencement. In case of an amendment in the percentage of the securities or in the tender offer price, the tender offer must remain open for at least 10 business days from the date of notice of the amendment.

The purchaser may extend the length of the tender offer by issuing a notice of extension by press release or by other public announcement no later than the scheduled original expiration date of the offer. The notice of extension must disclose the approximate number of securities tendered to date.

Any security tendered may be withdrawn by the security holder at any time during the period when the tender offer remains open or at any time after 60 business days from the commencement of the tender offer if the securities are not yet accepted for payment.

Except with the consent of the SEC, where an offer has been withdrawn, the purchaser or any person who acted in concert with him or her in the course of the offer cannot announce a new offer for the public company within six months from the time the initial offer was withdrawn. Neither can they acquire any of its equity securities that will obligate the purchasers to make a mandatory tender offer.

The purchaser is required to pay the tender offer price not later than 10 business days after the termination of the tender offer.

Listing Rules

Generally, an issuer may apply for listing in the First Board if it meets any of the following criteria:

- It has a track record of profitable operations for three years.
- It has a market capitalization of PHP500 million, and a five-year operating history.
- It has net tangible assets of PHP500 million, provided that it has a five-year operating history.
- It has an authorized capital stock of at least PHP400 million and a subscribed and paid-up capital of at least PHP100 million.

In addition, an issuer must have a cumulative consolidated pre-tax profit of at least PHP50 million and a minimum pre-tax profit of PHP10 million for each of the three full fiscal years immediately preceding the application for listing. The issuer must further be engaged in materially the same businesses and must have a proven track record of management throughout the last three years prior to the filing of the application.
There are, however, certain exceptions to the foregoing three-year track record rule:

- The issuer has been operating for at least 10 years prior to the filing of the application.
- The issuer is a newly formed holding company which uses the operational track record of its subsidiary(ies).

Under the second exception, the issuer is prohibited from divesting its shareholdings in the said subsidiary(ies) for a period of three years from the listing of its securities. This prohibition shall not apply if a divestment plan is approved by majority of the issuer’s stockholders.

An issuer that fails to comply with the capital and profitability requirements of the First Board may apply for listing in the Second Board. Said issuer must demonstrate its potential for superior Growth; have an operating history of at least one year prior to listing; have an authorized capital stock of at least PHP100 million, 25% of which must be subscribed and fully paid; have already disbursed at least 75% of its paid-up capital to the project, venture or business activities undertaken to advance its business pursuits and operational targets; and, at listing, have a minimum market capitalization of PHP250 million.

A company applying for listing on the First Board or Second Board shall cause its shareholders who own an equivalent of at least 10% of the issued and outstanding shares of stock of the company not to sell, assign or dispose of their shares for at least 180 days for First Board listing or 365 days for listing on the Second Board after listing the shares.

Furthermore, companies applying for listing on the Second Board must submit to the PSE a detailed report on active business pursuits and operational targets. This is not required for companies applying for listing on the First Board.

Companies applying for listing on either the First Board or the Second Board must submit to the PSE audited financial statements for the last three full fiscal years of the company and its subsidiaries prepared by an independent auditor. For companies applying for listing on the First Board, the audited financial statements shall be accompanied by a schedule of the ageing of its accounts receivable.

The PSE will generally not consider the application of a subsidiary or parent company of an existing listed issuer if the assets and operation of the applicant are substantially the same as those of the existing listed issuer. However, the PSE will take into consideration the applicant’s business or commercial reasons for listing in arriving at a decision.
The following are the methods of initial listing that may be adopted by the applicant company in its application for listing of its securities, subject to the requirements of the applicable board:

- **Primary Offering** - the original sale made to the investing public by the applicant company of its own securities (i.e., primary shares);

- **Secondary Offering** - an offer for sale made to the investing public by the existing shareholders of their securities which are already issued (i.e., secondary shares); or

- **By Way of Introduction** - refers to an application for listing of securities that are already issued or securities that will be issued upon listing, where no public offering will be undertaken because the securities for which listing is sought would be of such an amount and would be so widely held that their adequate marketability when listed can be assumed, or when listing in an exchange or public offering is mandated by law or by the SEC or other government agencies, in the exercise of its powers under the law.

Applicant companies applying to list in the First Board and Second Board are allowed to conduct both primary offering and secondary offering. For applicant companies applying to list by way of introduction, acceptance for listing shall be based on the listing criteria established by the Exchange in either the First Board or Second Board.
Public companies are required to make ongoing structured reports and unstructured disclosures to meet the requirements of the SEC and the PSE.

The purpose of the structured reports is to assure the public availability of continuing adequate information on publicly listed companies. These structured reports are generally intended to keep reasonably current the information and documents filed with the SEC and/or the PSE for the registration or listing of the securities.

On the other hand, unstructured disclosures are reports on corporate developments provided to the investing public as they occur. The purpose of the unstructured disclosures is to update the investing public with any material fact or event that occurs, which would reasonably be expected to affect investors’ decision in relation to trading of the company’s shares.

Structured Reports

The structured reports include:

- Annual report, which contains: business and general information on the company’s property, legal information, and submission of matters to a vote of security holders; operational and financial information including the market for the company’s common equity and related stockholder matters, management’s discussion and analysis or plan of operation, annual financial statements, and changes in, and disagreements with, accountants on accounting and financial disclosure; and control and compensation information including the company’s
directors and executive officers, executive compensation, security ownership of certain beneficial owners and management, and certain relationships and related transactions;

- Quarterly report, which contains the company’s financial statements, and management’s discussion and analysis of financial conditions and results of operations for the quarter. A quarterly report must be filed with the SEC within 30 days of the last day of March, June, September and December each year;

- Certification on the compliance by the company, its directors, and officers with the Revised Code of Corporate Governance;

- Certification on the attendance of the directors in the board of directors’ meetings;

- Report on the computation of the quarterly public ownership of the Company;

- Annual list of the stockholders of the company with the corresponding number of shareholdings and its percentage to the total issued and outstanding shares;

- List of top 100 stockholders of the company with the corresponding number of shareholdings and its percentage related to the total issued and outstanding shares;

- Report on the number of stockholders owning at least one board lot each;

- Information Statement to be filed prior to a stockholders’ meeting of the company;

- Report to be filed by a person who directly or indirectly acquires the beneficial ownership of more than 5% of the shares of the company; and

- Report to be filed by a person who directly or indirectly acquires the beneficial ownership of more than 10% of the shares of the company, or who becomes a director or an officer of the company, within 10 days after he or she becomes such beneficial owner, director or officer. A report must also be filed if there has been any change in such ownership within 10 days after the close of the calendar month in which the change occurred.

**Unstructured Disclosures**

Unstructured disclosures are disclosures to the investing public of material corporate developments or events, or conditions in the market for securities, as and when they occur. Not all corporate or market developments require
disclosure. However, information which meets any of the following standards generally requires immediate disclosure:

- Where the information is necessary to enable the public company and the public to appraise their position or standing, i.e., material information with a significant impact on the public company’s operations, including information concerning a significant change in ownership of the public company’s securities owned by insiders or representing control of the public company;

- Where the information is necessary to avoid the creation of a false market for its securities, such as rumors or reports, whether true or false, not originating from the public company; or

- Where the information may reasonably be expected to materially affect market activity, investor’s decisions and the price of securities.

The following items are considered material information requiring disclosure:

- Changes in control
- Acquisition or disposition of assets
- Changes in certifying accountant
- Resignation, removal or election of registrant’s directors or officers
- Legal proceedings
- Changes in securities
- Defaults upon senior securities
- Change in fiscal year
- Changes in corporate purpose and material alterations in activities or operations or initiation of new ones
- Resignation or removal of officers or senior management and their replacements
- Decisions to carry out extraordinary investments or financial or commercial transactions that might have material impact on the public company’s situation
- Significant losses
- Dissolution
- Serious obstructions in the development of corporate activities
- Any licensing or franchising agreement or its cancellation materially affecting operations
• Any delay in the payment of debentures, negotiable obligations, bonds, etc.
• Creation of mortgages or pledges on assets exceeding a significant part of net worth
• Any purchase or sale of stock or convertible debt securities of other companies when the amount exceeds a significant part of the public company’s or purchaser’s net worth
• Contracts that limit profit distribution
• Any fact that materially affects or might materially affect the economic, financial or equity situation of those companies controlling, or controlled by the public company including sale or pledge of an important part of such companies’ assets
• Authorization, suspension, retirement or cancellation of the listing of securities on an exchange
• Fines of more than PHP50,000 and/or penalties by regulatory authorities
• Merger, consolidation or spin-off

The unstructured disclosure of corporate developments must be made promptly to the public through the news media. If the public company has securities listed with the PSE, the disclosure must be made to the PSE within 10 minutes after occurrence of the event and prior to its release to the public through the news media. Also, disclosure must be made to the SEC within five days after occurrence of the event being reported unless substantially similar information as required has been previously reported to the SEC by the registrant.
### Summary of the structured reports to the SEC and the PSE

<table>
<thead>
<tr>
<th>Name of Report</th>
<th>Description</th>
<th>Date Due</th>
<th>Responsible Party</th>
</tr>
</thead>
<tbody>
<tr>
<td>SEC Form 17-A</td>
<td>Annual Report</td>
<td>Within 105 days after the end of the fiscal year</td>
<td>Prepared by management Signed by the principal executive officer, principal operating officer, principal financial officer, comptroller, principal accounting officer, corporate secretary or persons performing similar functions</td>
</tr>
<tr>
<td>SEC Form 17-Q</td>
<td>Quarterly Report</td>
<td>Within 45 days after the end of each of the first three quarters of each fiscal year</td>
<td>Prepared by management Signed by the principal financial or chief accounting officer</td>
</tr>
<tr>
<td>Certificate of compliance with the Manual of Corporate Governance (Certificate of Compliance)</td>
<td>Certification on the compliance by the public company, its directors and officers with the CG Manual</td>
<td>Every 30 January</td>
<td>Prepared and signed by the compliance officer</td>
</tr>
<tr>
<td>Certificate of attendance of directors in meetings of the board of directors (Certificate of Attendance)</td>
<td>Certification on the attendance of the directors in the board and committee meetings of the public company</td>
<td>Every 30 January</td>
<td></td>
</tr>
</tbody>
</table>
### Summary of the structured reports to the PSE

<table>
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<tr>
<th>Name of Report</th>
<th>Description</th>
<th>Date Due</th>
<th>Responsible Party</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarterly public ownership report (Public Ownership Report) Annual list of stockholders</td>
<td>Report on the computation of the quarterly public ownership of the public company Annual list of the stockholders of the public company with the corresponding number of shareholdings and its percentage to the total issued and outstanding shares</td>
<td>Within 15 trading days after the end of each quarter of the calendar year, provided that if the public float of a listed company falls below 12% of its issued and outstanding shares, exclusive of any treasury shares, the listed company shall submit a Public Ownership Report within 15 calendar days after the end of each month, until such time that its public float is 12% or higher.</td>
<td>Management Prepared by the stock transfer agent Management Prepared by the stock transfer agent</td>
</tr>
<tr>
<td>List of top 100 stockholders</td>
<td>List of top 100 stockholders of the public company with the corresponding number of shareholdings and its percentage to the total issued and outstanding shares</td>
<td>Within 15 calendar days after the end of each quarter of the calendar year</td>
<td>Management Prepared by the stock transfer agent</td>
</tr>
<tr>
<td>Report on the number of stockholders (Number of Stockholders Report)</td>
<td>Report on the number of stockholders owning at least one board lot each</td>
<td>Within five trading days after the close of each calendar month</td>
<td>Management Prepared by the stock transfer agent</td>
</tr>
</tbody>
</table>
If applicable, the following structured reports must be submitted to the SEC and the PSE

<table>
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<tr>
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<th>Description</th>
<th>Date Due</th>
<th>Responsible Party</th>
</tr>
</thead>
<tbody>
<tr>
<td>SEC Form 20-IS</td>
<td>Information statement to be filed prior to a stockholders’ meeting</td>
<td>SEC Form 20-IS shall be distributed to the stockholders at least 15 business days from the date of the stockholders’ meeting. A Preliminary SEC Form 20-IS shall be submitted at least 30 business days prior to the date the SEC Form 20-IS is distributed to the stockholders. A Definitive SEC Form 20-IS shall be filed prior to the date the SEC Form 20-IS is distributed to the stockholders.</td>
<td>Prepared by management</td>
</tr>
</tbody>
</table>
Specific Disclosure Obligation

Examples of the events which shall be reported and mandate prompt disclosure are listed in SEC Form 17-C and the PSE Revised Disclosure Rules. Unlisted events may still need to be reported if, in fact, they are material.

The specific events that are deemed material and the content of the disclosures required are as follows:

Change in Control

- If, to the knowledge of management, a change in control of the corporation has occurred, state the name of the person(s) who acquired such control; the amount and the source of the consideration used by such person(s); the basis of the control; the date and a description of the transaction(s) which resulted in the change in control; the percentage and actual number of shares of voting securities of the corporation now beneficially owned directly or indirectly by the person(s) who acquired control; and the identity of the person(s) from whom control was assumed.

- If the source of all or any part of the consideration used is a loan made in the ordinary course of business by a bank, the identity of the bank may be omitted. In lieu of this, the material shall indicate that disclosure of the identity of the bank has been omitted and filed separately with the SEC.

- The terms of any loans or pledges obtained by the new control group for the purpose of acquiring control, and the names of the lenders or pledgees shall be stated. Any arrangement or understanding among members of both the former and new control groups and their associates with respect to election of directors or other matters shall be described.

- Describe any arrangement known to the corporation, including any pledge by any person of securities of the corporation or any of its parents, the operation of which may at a subsequent date result in a change in control of the corporation.

Acquisition or Disposition of Assets

If the corporation or any of its majority-owned subsidiaries has acquired or disposed of a significant amount of assets or amounting to 10% or more of the company’s total assets, other than in the ordinary course of business, furnish the following information:

- The date and manner of the acquisition or disposition and a brief description of the assets involved; the nature and amount of consideration given or received;
the principle followed in determining the amount of such consideration; the identity of the person(s) from whom the assets were acquired or to whom they were sold and the nature of any material relationship between such person(s) and the corporation or any of its affiliates; any director or officer of the corporation, or any associate of any such director or officer. If the transaction being reported is an acquisition, identify the source(s) of the funds used unless all or any part of the consideration used is a loan made in the ordinary course of business by a bank in which case the identity of such bank may be omitted. In lieu of this, the material shall indicate that the identity of the bank has been omitted and filed separately with the SEC.

- If any asset so acquired by the corporation or its subsidiaries constituted plant, equipment or other physical property, state the nature of the business in which the assets were used by the persons from whom acquired and whether the corporation intends to continue such use or intends to devote the assets to other purposes, indicating such other purposes. (Provided, however, that no information need be given as to: any transaction between any person and any wholly-owned subsidiary of such person; any transaction between two or more wholly-owned subsidiaries of any person; or the redemption or other acquisition of securities from the public, or the sale or other disposition of securities to the public, by the corporation of such securities.)

- The term acquisition includes every purchase, acquisition by lease, exchange, merger, consolidation, succession or other acquisition; provided that such term does not include the construction or development of property by, or for the corporation or its subsidiaries or the acquisition of materials for such purpose.

- The term disposition includes every sale, disposition by lease, exchange, merger, consolidation, mortgage, or hypothecation of assets to secure a loan, assignment, whether for the benefit of creditors or otherwise, abandonment, destruction, or other disposition.

- An acquisition or disposition is deemed to involve a significant amount of assets if the corporation’s and its other subsidiaries’ equity in the net book value of such assets or the amount paid or received upon such acquisition or disposition exceeded 10% of the total assets of the corporation and its consolidated subsidiaries, or if it involved a business which is significant as defined in Annex B of the SRC Rules.
• Where assets are acquired or disposed of through the acquisition or disposition of control of a person, the person from whom such control was acquired or to whom it was disposed of shall be deemed the person from whom the assets were acquired or to whom they were disposed, for the purposes of this item. Where such control was acquired from, or disposed of to, not more than five persons, their names shall be given; otherwise it will suffice to identify in an appropriate manner the class of such persons.

• The corporation shall also submit: financial statements for businesses acquired; pro forma financial information; and copies of the plans of acquisition or disposition as exhibits to the report.

• The information called for by this item is to be given as to each transaction or series of related transactions of the size indicated. The acquisition or disposition of securities shall be deemed the indirect acquisition or disposition of the assets represented by such securities if it results in the acquisition or disposition of control of such assets.

Changes in the Corporation’s Certifying Accountant

Resignation or dismissal

If an independent accountant who was previously engaged as the principal accountant to audit the corporation’s financial statements, or an independent accountant of a significant subsidiary as defined in Annex B of the SRC Rules resigns (or indicates it declines to stand for re-election after the completion of the current audit) or is dismissed, disclose the reason and provide the information required by Part III, Paragraph (B) of Annex C of the SRC Rules.

Appointment of new independent accountant

If a new independent accountant has been engaged as either the principal accountant to audit the corporation’s financial statements or as an independent accountant on whom the principal accountant has expressed, or is expected to express, reliance in its report regarding a significant subsidiary, identify the newly engaged accountant and indicate the date of the accountant’s engagement.

Resignation, Removal or Election of the Corporation’s Directors or Officers

Resignation or removal

Disclose the name of any director or officer who has ceased to hold office, the date of any such cessation, the office held by any such person and the reason/s for such cessation. If a director has been removed by the corporation for cause, it shall provide a discussion of the reason for the removal.
If a director has resigned or declined to be re-elected to the board of directors since the date of the last annual meeting of stockholders because of a disagreement with the corporation on any matter relating to the corporation’s operations, policies or practices, and if the director has furnished the corporation with a letter describing such disagreement and requesting that the matter be disclosed, the corporation shall state the date of such resignation or declination to stand for re-election and summarize the director’s description of the disagreement. In such a case, the corporation shall file a copy of the director’s letter as an exhibit to Form 17-C. If the corporation believes that the description provided by the director is incorrect or incomplete, it may include a brief statement presenting its views on the disagreement.

**Election or appointment**

If a director or officer who has died, resigned or been removed has been replaced by the corporation or elected at any meeting of the stockholders, it shall state the name of the appointee or electee, the office to be held by such person, the date of such appointment or election, including the qualification and business experience for the past five years of such person.

If any director or officer is appointed or elected at any meeting of the stockholders or otherwise, then state the name, office, and date of such appointment or election.

Where a director is identified in one of the two above situations, disclose whether such person is an independent director. Indicate if a director or officer died.

**Legal Proceedings**

Furnish the information required by Part I, Paragraph (C) of Annex C of the SRC Rules. If proceedings have been terminated, provide similar information, including the date of termination and a description of the disposition with respect to the corporation and its subsidiaries.

Also, describe briefly any material pending legal proceedings to which the corporation or any of its subsidiaries or affiliates is a party or of which any of their property is the subject. Include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties, a description of the factual basis alleged to underlie the proceeding and the relief sought. Include similar information as to any such proceedings known to be contemplated by governmental authorities or any other entity.
Changes in Securities
If the constituent instruments defining the rights of the holders of any class of registered securities have been materially modified, give the title of the class of securities involved and state briefly the general effect of such modification upon the rights of holders of such securities.

If the rights evidenced by any class of registered securities have been materially limited or qualified by the issuance or modification of any other class of securities, state briefly the general effect of the issuance or modification of such other class of securities upon the rights of the holders of the registered securities.

Defaults upon Senior Securities
If there has been any material default in the payment of principal, interest, a sinking or purchase fund installment, or any other material default not cured within 30 days, with respect to any indebtedness of the corporation or any of its significant subsidiaries exceeding 5% of the total assets of the corporation and its consolidated subsidiaries, identify the indebtedness and state the nature of the default. In the case of such a default in the payment of principal, interest, or a sinking or purchase fund installment, state the amount of the default and the total arrearage on the date of filing this report. Only events which have become defaults under the governing instruments, i.e., after the expiration of any period of grace and compliance with any notice requirements, need be reported.

If any material arrearage in the payment of dividends has occurred or if there has been any other material delinquency not cured within 30 days, with respect to any class of preferred stock of the corporation which is registered or which ranks prior to any class of registered securities, or with respect to any class of preferred stock of any significant subsidiary of the corporation, give the title of the class and state the nature of the arrearage or delinquency. In the case of an arrearage in the payment of dividends, state the amount and the total arrearage on the date of filing this report.

Defaults or arrearages with respect to any class of securities all of which is held by, or for the account of, the corporation or its totally held subsidiaries, need not be reported pursuant to this item.

Disclose how long the defaults will occur and the sources of funds for payment.

The terms of the plan of payment or of any restructuring agreement shall be disclosed in the current report.
Change in Fiscal Year
If the corporation decides to change its fiscal year from that used in its most recent filing with the SEC, state the date such determination was made, the period of the new fiscal year and the period from which the fiscal year was changed.

Other Events
The corporation shall report every fact or event that occurs which would reasonably be expected to materially affect the decision of investors to buy, sell or hold securities. To the extent not covered above, the following are illustrative of the types of events required to be reported under this item. This list is only indicative and will not relieve anyone of the obligation to inform the public, the PSE and the SEC of every other act which may reasonably be considered to materially affect the corporation’s securities or investors’ decisions.

- Changes in the corporation’s corporate purpose and any material alteration in the corporation’s activities or operations or the initiation of new ones
- Resignation or removal of officers or senior management and their replacements
- Any decision taken to carry out extraordinary investments or the entering into financial or commercial transactions that might have a material impact on the corporation’s situation (1)
- Losses of a significant part of the corporation’s net worth
- Occurrence of any event of dissolution with details provided
- Acts and facts of any nature that might seriously obstruct the development of corporate activities, specifying its implications on the corporation’s business
- Any licensing or franchising agreement or its cancellation which may materially affect the corporation’s operations
- Any delay in the payment of debentures, negotiable obligations, bonds or any other publicly traded security
- Creation of mortgages or pledges on assets when they exceed a significant part of the corporation’s net worth
- Any purchase or sale of stock or convertible debt securities of other companies when the amount exceeds a significant part of the corporation’s or purchaser’s net worth (2)
- Contracts of any nature that might limit the distribution of profits with copies thereof
Guide to Mergers and Acquisitions

- Postponement of stockholders’ meeting according to the by-laws or as previously scheduled
- Declaration of any kind of dividend
- Change in business address or location of principal plant
- Facts of any nature that materially affect or might materially affect the economic, financial or equity situation of those companies controlling, or controlled by the corporation including the sale of or the constitution of sureties/pledges on an important part of such the corporation’s assets
- Authorization, suspension, retirement or cancellation of the listing of the corporation’s securities on an exchange or organized over-the-counter electronic marketplace domestically or abroad
- Fines of more than PHP50,000 and/or other penalties to the corporation or to its subsidiaries by regulatory authorities and the reasons therefore
- Merger, consolidation or spin-off of the corporation (3)
- Entry into or termination of a material agreement not made in the ordinary course of business
- Termination or reduction of a business relationship with a customer that constitutes a significant amount of the company’s resources
- Events triggering a direct or contingent financial obligation that is material to the company, including any default or acceleration of an obligation
- Material modifications to rights of holders of the company’s securities
- Grant of the subscription rights to new shares as stock options
- Credits of subsidiary become likely to be in default
- Material conditional provisions in any agreement concerning ownership or control
- Changes in a material contract which may have financial, technological or administrative impact on the company
- Renegotiations or restructuring of debts
- Modification of disclosed projects by the company
- Any restructuring of the company’s equity which has been approved by the board of directors
Similar transactions as items marked (1), (2) and (3) above, entered into by any director, officer or substantial stockholder of the corporation as a representative of a group of companies in which the corporation is a member.

The term group of companies refers to various companies which are owned or controlled by a person who directly, or indirectly through one or more persons or intermediaries, controls, or is controlled by, or is under common control with, the person specified, or whose three or more directors, officers or substantial stockholders are the same persons.

With respect to information which is not otherwise identified above, the corporation may optionally also report under this item any events that the corporation deems important to security holders.

**Fraud and Error**

The corporation shall describe any of the following findings by its external auditor during the conduct of audit for the company’s recently completed fiscal year, and determined in accordance with generally accepted auditing standards:

- Any material finding/s involving fraud or error
- Losses or potential losses the aggregate of which amounts to at least 10% of the consolidated total assets of the company
- Any finding to the effect that the consolidated assets of the company, on a going concern basis, are no longer adequate to cover the total claims of creditors

Fraud means an act proven intentional, by one or more individuals among management, employees, or third parties that results in a misrepresentation of financial statements, which will reduce the consolidated total assets of the company by at least 5%. It may involve:

- manipulation, falsification or alteration of records or documents;
- misappropriation or diversion of assets;
- suppression or omission of the effects of transactions from records or documents;
- recording of transactions without substance; or
- misapplication of accounting policies.
Error means an unintentional mistake in financial statements, which will reduce the consolidated total assets of the company by 5%. It may involve:

- mathematical or clerical mistakes in the underlying records and accounting data;
- oversight or misinterpretation of facts; or
- misapplication of accounting policies.

Financial Statements and Exhibits

Listed below are the financial statements, pro forma financial information and exhibits, if any, to be filed as part of the disclosure.

Financial statements of businesses acquired

For any business acquisition required to be described under Acquisition or Disposition of Assets above, financial statements of the business acquired shall be filed for the period specified in SRC Rule 68.1.

Note that Paragraph 5 of SRC Rule 68.1 may require, depending upon the relative size of the business to be acquired to the size of the corporation, that financial statements of the business to be acquired be audited for as much as three years. If it has been deemed impractical to complete an audit of the business to be acquired, for the period required by Paragraph 5 of SRC Rule 68.1, this filing should include a letter from an auditor explaining the work that has been done to determine whether an audit could be completed. The letter also should explain briefly the basis for the conclusion that it is not practical to complete an audit (e.g., the acquired business did not maintain inventory records and it is not practicable to do any alternative auditing steps that would establish inventory values at financial statement dates and costs of sales for periods of time covered by income statements).

The financial statements shall be prepared pursuant to SRC Rule 68 except that supporting schedules need not be filed. A manually signed accountant’s report should be provided pursuant to SRC Rule 68, as amended.

If it is impractical to provide the required financial statements for an acquired business at the time the report on SEC Form 17-C is filed, the corporation should:

- so indicate in the SEC Form 17-C report;
- file such required financial statements as are available;
- state when the required financial statements will be filed; and
- file the required financial statements for an acquired business as an amendment to this Form as soon as practicable, but not later than 60 days after the report on Form 17-C has been filed. In such circumstances, the corporation may, at its option, include unaudited financial statements in the initial report on Form 17-C. Requests for additional extensions of time will not be considered.

When it is impractical to provide the required financial statements for an acquired business pursuant to the foregoing paragraph and during the period of extension, the corporation will be deemed current for purposes of its reporting obligations under Section 17 of the SRC.

Pro forma financial information

For any transaction required to be described in answer to Acquisition or Disposition of Assets above, furnish pro forma financial information required by paragraph 9 of SRC Rule 68.1.

The effect of an extension when it is impractical to provide the required financial statements, as described above, shall also apply to pro forma financial information relative to the acquired business.

Additional Requirements of the PSE in regard to Specific Disclosures

The PSE imposes additional regulations in regard to the following disclosures.

Clarification of non-public material information

Upon its receipt of any material non-public information, the PSE shall request the corporation concerned to confirm or deny the veracity of the said information (e.g., newspaper/newswire reports, information coming from third parties, broker’s market letter) pertaining to the corporation or any of its subsidiaries.

If the request for confirmation is made by the PSE prior to the pre-open period of the said trading day, the corporation must reply prior to the start of the said pre-open period. However, if the PSE makes a request for confirmation after trading hours, the corporation must reply prior to the start of the pre-open period of the next trading day.

The PSE shall impose a trading halt on the securities of the corporation if it fails to confirm or deny the veracity of the said material non-public information. The halt shall be lifted at 10 a.m., even in the absence of any reply from the
corporation verifying or clarifying the material information. The PSE must receive
the corporation’s reply not later than 11 a.m. of the same trading day. If by 11 a.m., the
corporation fails to reply or should the reply fail to sufficiently clarify the material
information requested by 11 a.m., it shall be fined the amount of PHP30,000.
Thereafter, the corporation shall be fined the additional amount of PHP10,000 for
every 30 minutes of delay.

The imposition of the foregoing penalties shall be without prejudice to the
imposition of penalty/ies for non-disclosure of material information after the
same has been duly established and the need to pursue investigation of a possible
violation of the anti-manipulative and anti-fraudulent provisions of the SRC.

Disclosure for substantial acquisitions and reverse takeovers

When the corporation or its subsidiary has merged or consolidated with, or
otherwise acquires, a direct or indirect interest in an unlisted company, person
or group, and said interest is 10% or more of the total book value of the listed
company, the trading of the securities of the listed company shall be suspended
until the terms and conditions of the transaction, and the details pertaining to the
business or project acquired are actually disclosed and, if applicable, the latest
audited financial statements of the unlisted company, are submitted to the PSE.

This however, shall not apply to cases where the corporation has merged or
consolidated with or otherwise acquires an interest in its existing subsidiary(ies).

Disclosure of dividend declarations

The corporation must disclose dividend declarations as approved by its board of
directors and stockholders.

Disclosure of record date

The corporation must set the record date in accordance with the Rules of the SEC
and when appropriate, of the Rules of the BSP. The disclosure of the record date
must not be less than 10 trading days from the said date.

Determination of payment date

The corporation must set the payment date in accordance with the rules of the
SEC and when appropriate, of the Rules of the BSP. The payment date shall not be
more than 18 trading days from the record date.

If the dividend declaration is still subject to approval by a regulatory agency, GPHC
should indicate in its disclosure that the announced dates may change depending
on the approval by the respective agency.
Disclosure on stockholders meetings

For the holding of any stockholders’ meeting, the PSE must be given a written notice at least 10 trading days prior to the record date fixed by the corporation. The notice must include all the necessary details including the time, venue, and agenda of the meeting and the inclusive dates when the stock and transfer books will be closed. The corporation shall further submit within five trading days after the record date the list of stockholders who are entitled to notice and to vote at a regular or special stockholders’ meeting.

Disclosure of the amendments to the Articles of Incorporation and By-Laws

Upon approval by the SEC of the amendment to the Articles of Incorporation and By-Laws of a corporation, the following should be submitted to the PSE within two trading days:

- SEC Certified True Copy of the Amended Articles of Incorporation and By-Laws
- Detailed procedure to be undertaken by the corporation in amending its stock certificates, if required

Disclosure of acquisition of outstanding shares and sale of treasury shares

The corporation must promptly disclose any planned acquisition of its shares or disposition of treasury shares. In addition, the corporation must submit a disclosure regarding the actual number of shares and the transaction price for each acquisition or disposition of its own shares prior to the pre-open period of the next trading day after the transaction was executed. The planned acquisition or disposition must likewise be in accordance with the rules and regulations of the SEC.

Disclosure of acquisition by the corporation’s subsidiaries, affiliates and others

The corporation must submit a disclosure to the PSE regarding the actual number of shares and the transaction price for each acquisition or disposal of the corporation’s shares by its subsidiaries, affiliates or entities controlled or managed by the corporation prior to the pre-open period of the next trading day after the transaction was executed or such other related information that the PSE may require.

Disclosure of pending release of shares held under voluntary lock-up

The corporation must notify the PSE of the release of the shares held under escrow not earlier than 15 trading days but not later than 10 trading days before the end of the voluntary lock-up period.
Disclosure on change of stock transfer agent

The corporation must notify the PSE on or before the pre-open period of the next trading day of a decision to terminate the services of its Stock Transfer Agent and the reasons for such termination. The notice should in any case be filed with the PSE no later than 30 days prior to the termination becoming effective.

A new Stock Transfer Agent should be engaged by the corporation no later than 10 trading days prior to the effective date of the termination of services of the original Stock Transfer Agent. Notice to the PSE that the corporation has engaged a new Transfer Agent must be filed within the same period. Upon failure to comply with this requirement, the PSE shall suspend trading of securities of the corporation which shall be lifted upon receipt of notice of the engagement of a new Stock Transfer Agent.

Disclosure on transactions of directors and principal officers in the corporation’s securities

Corporations must disclose to the PSE the direct and indirect ownership of its directors and principal officers in its securities within two trading days after:

- the corporation’s securities are first admitted in the Official Registry of the PSE;
- a director is first elected or an officer is appointed; or
- any acquisition, disposal, or change in the shareholdings of the directors and officers.

A director or a principal officer of a corporation must not deal in the corporation’s securities during the period within which material non-public information is obtained and up to two full trading days after the price-sensitive information is disclosed.

Company and analyst/investors briefings

The corporation must notify the PSE of its company and analyst/investors briefings at least three trading days prior to the scheduled date.

Unusual trading activity

Unusual trading activity involving a corporation’s securities which occurs without any apparent reason gives rise to the presumption that there is insider trading or a rumor or report, whether true or false, about the corporation.
Whenever there is unusual trading activity in a corporation’s securities, the corporation must respond promptly to any inquiry made by the PSE concerning the unusual trading activity.

If the unusual trading activity results from the leak of material information, the information in question must be announced promptly. If the unusual trading activity results from a false rumor or report, the PSE’s policy on correction of such rumors and reports should be complied with.

If the listed corporation is unable to determine the cause of the unusual trading activity, it must make a disclosure to the PSE to the effect that there are no undisclosed recent developments affecting the corporation that would account for the unusual trading activity.

Any response made by the authorized officer of a corporation is presumed to have been made after consulting the chairman of the board, president or corporate secretary of the corporation.

**Timetable**

Disclosures must be timely, fair, complete and accurate. They must be factual, clear and succinct and must contain sufficient quantitative information to allow investors to evaluate the material event’s relative importance to the activities of the corporation.

To be timely, the disclosure must be made to the PSE within 10 minutes after notice to the corporation or occurrence of the event and prior to its release to the public through the news media, and to the SEC on SEC Form 17-C within five days after occurrence of the event.
CONCLUSION

In the Philippines, share acquisitions and asset acquisitions continue to be the method of choice for most purchasers. Mergers and consolidations are thriving in the banking and telecommunications sector. In the banking sector, the activity has been triggered by BSP regulations increasing the capital requirements for banks already in operation as well as those yet to be established. Banks failing to meet the minimum capital requirements face possible suspension of some of their functions and privileges. In the telecommunications sector, the activity appears to have been triggered by the aggressive competition among telecommunications companies, particularly those engaged in wireless communications. The Philippine M&A market is developing. Although basic legislation relating to or affecting mergers and acquisitions exists, the SEC continues to issue new rules and regulations to keep pace with the developments in the Philippine M&A market.
APPENDIX A

2012 Investment Priorities Plan
MALACAÑAN PALACE
MANILA

BY THE PRESIDENT OF THE PHILIPPINES

MEMORANDUM ORDER NO. 40

APPROVING THE 2012 INVESTMENT PRIORITIES PLAN

Pursuant to Article 29 of the Omnibus Investment Code of 1987; as amended, the attached 2012 Investment Priorities Plan (IPP) is hereby APPROVED. Further to the provision of said Article, upon the effectivity of the IPP, all government agencies and entities are enjoined not to adopt any policy or take any course of action contrary to or inconsistent with the IPP.

This Memorandum Order shall take effect fifteen (15) days after its publication in a newspaper of general circulation as required under Article 31 of the Omnibus Investment Code of 1987.

DONE, in the City of Manila, this 13th of June, in the year of our Lord, Two Thousand and Twelve.

By the President:

PAQUITO N. OCHOA, JR.
Executive Secretary
The Philippine economy continues to expand at a dynamic pace despite today’s global uncertainties, registering a significant increase in credit ratings and confidence levels in the leading development indices.

Simultaneous with these ratings upgrade, our Board of Investments posted unprecedented investment approvals of over PhP368 billion just last year.

These promising reports give me confidence that our policy interventions and structural reforms are taking root, and my administration remains committed to sustaining this momentum of progress and moving towards becoming a model of stability and prosperity in the region.

For this purpose, we have strategically calibrated the 2012 Investment Priorities Plan (IPP) to further strengthen last year’s investment generation agenda, ensuring that our new initiatives will address present economic challenges and effectively establish sustainable gains. This year’s IPP has been crafted to focus on four critical areas: job generation, enhanced delivery of social services, international competitiveness, and climate change mitigation and adaptation.

Anchored on the theme, “A New Day for Investments: ‘Coherent, Consistent, and Creative’” the 2012 IPP Plan is a commitment to the business community that my Administration is steadfast in sustaining a predictable, reliable, and efficient Philippine investment landscape.

With the 2012 IPP, together with our instituted governance and business environment reforms, we look forward to stronger investor partnerships, in accordance with our goal of stability and equitable progress.

BENIGNO S. AQUINO III

MANILA
June 2012
INVESTMENT PRIORITIES PLAN
2012

The coverage, description and entitlement to incentives of the following listed activities shall be defined and clarified in the General Policies and Specific Guidelines to be issued by the Board of Investments (BOI).

The extent of entitlement to incentives shall be based on the project’s net value added, job generation, multiplier effect and measured capacity

I. PREFERRED ACTIVITIES

1. Agriculture/Agribusiness and Fishery
   This covers commercial production and commercial processing of agricultural, herbal and fishery products (including their by-products and wastes).
   This also covers agriculture- and fishery-related activities such as irrigation, post harvest, cold storage, blast freezing, and the production of fertilizers and pesticides.

2. Creative industries/Knowledge-Based Services
   This covers business process outsourcing (BPO) activities, and IT and IT-enabled services that involve original content.

3. Shipbuilding
   This covers the construction and repair of ships. This also covers shipbreaking/shiprecycling.

4. Mass Housing
   This covers the development of low-cost mass housing. This also covers the manufacture of modular housing components preferably using indigenous materials.

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1 Section 20 of EO 226 defines measured capacity as the estimated additional volume of production or service which the Board determines to be considerable in each preferred area of investment in order to supply the needs of the economy at reasonable prices, taking into account the export potential of the product including economies of scale which would render such product competitive in the world market. Measured capacity shall not be less than the amount by which the measurable domestic and country’s potential export market demand exceeds the existing productive capacity in said preferred areas. For export market industries, when warranted, the Board shall base measured capacity on the availability of domestic raw materials after deducting the needs of the domestic market therefor.
5. **Iron and Steel**
   This covers basic iron and steel products, long steel products (billets and reinforcing steel bars), and flat hot-/cold-rolled products.

6. **Energy**
   This covers the exploration, development, and/or utilization of energy sources adopting environmentally-friendly technologies.

7. **Infrastructure**
   This covers transport, water, logistics, waste management facilities, physical infrastructure (tollways, railways and telecommunication facilities), and PPP projects.

8. **Research and Development**
   This covers R&D activities and the establishment of research/ testing laboratories, Centers of Excellence (COE) and technical vocational education and training institutions.

9. **Green Projects**
   This covers the manufacture/assembly of goods and the establishment of energy efficiency-related facilities (such district cooling systems), where either utilization of which would significantly bad to either the efficient use of energy, natural resources or raw materials; minimize/prevent pollution; or reduce greenhouse gas emissions.

10. **Motor Vehicles**
    This covers the manufacture/assembly of motor vehicles, including alternative fuel vehicles (AFVs) and electric vehicles (EVs) but excluding two-stroke motorcycles, and manufacture of motor vehicles parts and components.

11. **Strategic Projects**
    This covers projects that exhibit very high social economic returns that will significantly contribute to the country’s economic development.

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2 Projects under these activities will be approved upon determination by the Board in consultation with the DOF, NEDA and other appropriate government agencies.
12. Hospital/Medical Services
This covers the establishment and operation of primary and secondary hospitals.

13. Disaster Prevention, Mitigation and Recovery Projects
This covers projects that will prevent or mitigate adverse impacts of calamities and disasters (e.g., installation of flood control systems, installation of early warning systems for typhoons, earthquake occurrences, tsunami, volcanic eruptions, dikes, etc.).

This also covers projects to rehabilitate areas affected by calamities and disasters (e.g., rebuilding of roads and bridges after earthquakes/floodings, volcanic eruptions, oil spill clean-up, etc.).

This further covers training for disaster preparedness, mitigation or recovery/rehabilitation/reconstruction.

II. MANDATORY LIST
This covers activities that require their inclusion in the IPP as provided for under existing laws.

1. Industrial Tree Plantation
This covers extensive plantation of forest land of tree crops (except fruit trees) for commercial and industrial purposes.

1. Exploration, Mining, Quarrying and Processing of Minerals
This covers the exploration and development of mineral resources, mining/quarrying and processing of metallic and none-metallic minerals.

1. Publication or Printing of Books/Textbooks
This covers printing, re-printing, publication and content development of books or textbooks.

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3 P.D. No. 705 (Revised Forestry Code of the Philippines)
4 R.A. No. 7942 (Philippine Mining Act of 1995)
5 R.A. No. 8047 (Book Publishing Industry Development Act)
1. **Refining, Storage, Marketing and Distribution of Petroleum Products**
   This covers refining, storage, distribution, and marketing of petroleum products.

2. **Ecological Solid Waste Management**
   This covers the establishment of waste recycling facilities.

3. **Clean Water Projects**
   This covers the establishment of wastewater treatment facilities, and sewage collection integrated with treatment facilities and the adoption of water pollution control technology, cleaner production and waste minimization.

4. **Rehabilitation, Self-Development and Self-Reliance of Persons with Disability**
   This covers the manufacture of technical aids and appliances for the use and/or rehabilitation of persons with disability, and the establishment of special schools, homes, residential communities or retirement villages solely to suit the needs and requirements of persons with disability.

5. **Renewable Energy**
   This covers developers of renewable energy facilities, including hybrid systems.

6. **Tourism**
   This covers tourism enterprises that are outside the tourism enterprise zones (TEZs) and are engaged in the following:
   1. Tourist transport services whether for land, sea and air transport for tourist use;

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6  R.A. No. 8479 (Downstream Oil Industry Deregulation Act of 1998)
7  R.A. No. 9003 (Ecological Solid Waste Management Act of 2001)
8  R.A. No. 9275 (Philippine Clean Water Act of 2004)
9  R.A. No. 7277 (Magna Carta for Persons with Disability)
10 R.A. No. 9513 (Renewable Energy Act of 2008)
11 R.A. No. 9593 (Tourism Act of 2009)
2. Establishment and operation of:
   - Accommodation establishments such as but not limited to hotels, resorts, apartment hotels, tourist inns, motels, pension houses, private homes for homestay, ecolodges, condotels, serviced apartments, and bed and breakfast facilities;
   - Convention and exhibition facilities or “meetings, incentives, conventions and exhibition” (MICE) facilities;
   - Amusement parks;
   - Adventure and ecotourism facilities;
   - Sports facilities and recreational centers;
   - Theme parks;
   - Health and wellness facilities such as but not limited to spas, tertiary hospitals, and ambulatory clinics;
   - Agri-tourism farms and facilities; and
   - Tourism training centers and institutes.

3. Development of retirement villages.

4. Restoration/preservation and operation of historical shrines, landmarks and structures.

III. EXPORT ACTIVITIES

This covers the manufacture of export products, services exports and activities in support of exporters.

IV. ARMM LIST

The ARMM List covers priority activities that have been identified by the Regional Board of Investments of the ARMM (RBOI-ARMM) in accordance with E.O. No. 458. The RBOI-ARMM may also register and administer incentives to activities in this IPP for projects locating in the ARMM.

   A. Export Activities
      1. Export Trader and Service Exporters
      2. Support Activities for Exporters
B. Agriculture, Agribusiness/Aquaculture & Fishery
This covers the production and processing of agricultural and fishery products (production of “Halal” meat and foods), vegetable oils, food crops, integrated coconut processing and plantation, activated carbon, production of beverage crops and plantation, seaweeds production and processing, fruit processing, aquaculture (fish production and processing), young/sweet corn production, potato and sweet potato plantation/processing, cutflower production/processing, abaca plantation/processing, oil palm plantation/processing/refining and germinated oil palm seeds, feeds production, jatropha plantation/processing, sugarcane plantation/processing and refineries, quality seed and seedlings of fruit trees and other planting materials propagated asexually or by tissue culture, pearl culture/processing, production of livestock and poultry that includes processing, crocodile farming and processing, sericulture, feeds production and production of plantation crops and other pharmaceuticals, medical herbs/essential oil plants, biomass, rubber, carrageenan, mangosteen and moringa.

C. Basic Industries
This covers the production of pharmaceuticals such as antibiotics and medical devices, textile and textile products, inorganic and organic fertilizers using solid wastes materials, mining exploration and development of mineral resources (mining and quarrying of metallic and non-metallic minerals which includes small scale as defined under P. D. 1899 but to exclude river beds in operations and processing of minerals such as beneficiation and other metallurgical methods) and cement production of at least 1.0 million MTPY capacity (clinker based).

D. Consumer Manufactures
This covers processing of rubber products to be integrated with plantation and leather products.

E. Infrastructure and Services
This covers public utilities with developmental route of the five provinces and one city of ARMM and other adjacent cities and provinces such as common carriers, electric transmission/distribution, water supply facilities/waterways and sewerage systems, buses/cargo trucks, other specialized mass transport systems, power generation like hydro power, geothermal and natural gas, and telecommunications with international gateways.
F. Industrial Service Facilities
This covers testing and quality control laboratories, training and demonstration centers, tool shops and similar facilities, metal casting, metal working, furniture, ceramics and food processing, petrochemical complex and industrial gases.

G. Engineering Industries
This covers engineering products, electronics and telecommunication products, fabrication of construction materials and hydropower plant.

H. Logistics
This covers the transportation of cargoes and/or passengers (air, sea and/or land) and freight/cargo forwarding.

I. BIMP – EAGA Trade and Investment Enterprises
This covers enterprises located or have their base of operation in the BIMP – EAGA, namely, Brunei; Sabah and Sarawak in Malaysia; Maluku, Sulawesi, Kalimantan and Iringaya in Indonesia; and Mindanao and Palawan in the Philippines, who shall invest and engage in economic activity in the ARMM including the age old Traditional Barter Trading System in the BIMP – EAGA.

J. Tourism
This covers the establishment of tourism estate subject to guidelines developed jointly by RBOI-ARMM and the Department of Tourism – ARMM, tourist accommodation facilities, tourist transport facilities and development of retirement villages which shall include health and medical facilities including amenities required by the Philippine Retirement Authority (PRA) and subject to the guidelines to be approved by RBOI-ARMM in consultation with the PRA, the Department of Health (DOH), the Regional Planning and Development Office (RPDO) and other concerned agencies.

K. Health and Education Services and Facilities
This covers the establishment of private hospitals, medical clinics, wellness centers, primary education, secondary education, tertiary education (colleges, universities and vocational - technical schools) and ancillary services including any and all health and education related investment.

L. Halal Industry
This covers services and the production and processing of products under muslim or islamic law.
Notice is hereby given that the Board, in its meeting of 04 September 2012, approved the following General Policies and Specific Guidelines to implement the 2012 Investment Priorities Plan (IPP).

**Part I**

**DEFINITION OF TERMS**

- **Book** - a printed non-periodical publication of at least forty-eight (48) pages, exclusive of cover pages, published in the country and made available to the public.

- **Content Development of Books** consists of the following:
  1. Development of new technologies directly related to book printing or publishing, such as but not limited to digitization, electronic books (E-books), internet-based archiving and retrieval systems, electronic content creation and development systems, educational and/or “how-to” audio-visual presentations with or without interactive segments, and the like.
  2. Research and development activities directly related to book printing or publishing, such as but not limited to translation, editing, analysis and/or interpretation of text and materials into local dialects or adaptation/application to the domestic setting.

- **Distribution** - refers to bunkering and fuels shipping and transport. Fuels shipping and transport cover shipping and transport through land such as tank trucks, lorries and pipeline and tankers, and barges for the fuels to get to the points or areas where they are needed. Bunkering covers the activity of selling fuel for direct use by a vessel, usually for water and air transport, through a smaller transport vessel. Distribution projects are limited to those utilizing brand new equipment and double-hulled vessels.
- **Existing Project** - refers to a project of an existing enterprise that has started commercial operation at the time of application with the Board.

- **Expansion Project** - refers to a project of an existing enterprise that would involve the installation of additional facilities/equipment that will result in increase in capacity of the same/similar activity within the same existing plant/facilities of the enterprise. Projects that do not qualify as new shall be considered as expansion.

- **Fulfillment house/center** - refers to a facility that offers to store, receive the orders, package, and then ship the ordered item to the end consumer, on behalf of the product owner.

- **Government Guarantee** - refers to the rate of return granted by the regulating agency to include profit and the recovery of capital expenditure [guaranteed rate of return], assured payment whether or not services/product were produced/delivered [take or pay provision], and assurance to lender by a government agency that a financial obligation will be honored even if the borrower is unable to repay the debt.

- **Government Subsidy** - refers to the financial contribution by the national government or any of its agencies to defray, pay for or shoulder a portion of the project cost or the expenses and costs in operating or maintaining the project.

- **Job Generation** - refers to the number of jobs directly generated by the project.

- **Marketing of Petroleum Products/Natural Gas** covers the following:
  
a. Retailing or selling in retail generally directed to the end users, through dispensing pumps in stations or in packaged containers such as drums for the liquid fuels or metal cylinders that are compliant with PNS. This includes the establishment and operation of gasoline/natural gas stations and retailing.

b. Fuels bulk marketing or selling in wholesale through tank trucks, lorries, double-hulled vessels/tankers, barges or pipelines, which may be sourced from one’s own storage facilities. Investment shall include underground tanks and other equipment intended for fuels retailing through outlets such as gasoline/natural gas stations and LPG/LNG outlets.

c. A combination of storage, distribution, and marketing activities.
• **Measured Capacity** - the estimated additional volume of production/service which the Board determines to be desirable in each preferred area of investment taking into account the export potential of the product. For mass housing projects, the estimated housing backlog in the country shall be the basis of measured capacity.

• **Modernization Project** - refers to a project of an existing enterprise that would involve improvements in systems, processes, equipment, and/or facilities that must result in any of the following:
  1. at least 25% substantial reduction of production cost/cost of provision of the service; or
  2. upgrading of product/service quality or classification of the facility (e.g., hospitals, hotels, resorts) to a higher class in accordance with accreditation standards applicable to the industry concerned.

• **Multiplier Effect** - refers to the increase in economic activity and interrelationships generated and stimulated by the investment.

• **New Plantation Area** - refers to new hectarage of plantation or lands that have been idle for at least one year or those involving change of crops/variety to achieve higher yield or shifts in the production system such as organic farming.

• **New Project** - refers to a project/activity listed in the IPP that has not started commercial operation undertaken by:
  1. A newly organized/formed enterprise that:
     i. has no common stockholders in any existing enterprise, or
     ii. has common stockholders in the existing enterprise but own not more than fifty percent (50%) of equity in the new enterprise, or
     iii. has common stockholders but will engage in an entirely distinct and separate activity, or
     iv. has common stockholders (regardless of percentage of common ownership) and will engage in the same activity as that of the existing enterprise but will locate in a different municipality, province, or region.
  2. An existing enterprise that shall engage in:
     i. An entirely distinct and different activity from its existing business operations; or
ii. The same activity provided it shall establish a new facility\textsuperscript{12} in an area not contiguous to the premises of its existing project and with new investments.

3. An enterprise involving the manufacture of products utilizing local R&D. Applications for registration utilizing local R&D must be endorsed by the Department of Science and Technology (DOST) stating that this was undertaken in the Philippines and has not yet been commercialized.

4. For industrial tree plantations, an enterprise involved in the development of any public or private land to plantation of timber and non-timber species to supply the raw material requirements of forest-based industries. It also includes plantation with existing tree crops, which have not yet reached commercial harvest.

- **Net Value-added** - refers to the value of final product/service less the value of inputs. The project’s net value added should be at least 25% except for projects dependent on imported raw materials/supplies.

- **Storage** - refers to the business of receiving/discharging and storing petroleum crudes and/or products of others for compensation or profit.

- **Textbook** - refers to an exposition of generally accepted principles in one subject, intended primarily as a basis of instruction in a classroom or pupil-book-teacher situation.

- **Upgrading** - refers to the improvement of the facility/infrastructure by adding or replacing components. This may be treated as an expansion/modernization project.

\textsuperscript{12} New facility refers to new complete line used in the production of the registered product/service separate from existing line.
Part II
GENERAL POLICIES

I. APPROVAL OF APPLICATION AND ENTITLEMENT TO INCENTIVES

The approval of application for registration and entitlement to incentives under this IPP is subject to Article 7, paragraph 3 of Executive Order (E.O.) No. 226.

The approval of applications for registration shall be based on the IPP listing. However, the extent of entitlement to incentives shall be based on the project’s net value-added, job generation, multiplier effect and measured capacity.

The BOI, if national interest requires, may deny registration of projects engaged in the export of a product including industry inputs that are in short supply domestically.

II. EQUITY OWNERSHIP

Except as provided for under the Constitution and the Foreign Investment Act (Republic Act No. 7042, as amended), there are no restrictions on foreign ownership of export-oriented and/or pioneer enterprise that will engage in the activities listed in the IPP.

III. EQUITY REQUIREMENT

The equity of the project applied for registration is 25% of the project cost unless exempted under any of the following:

1. Projects of applicant with good track record in implementing registered project;
2. Projects of publicly-listed companies; or
3. Projects not entitled to ITH.

For large projects with a gestation period of more than one (1) year, the 25% equity requirement shall be based on the annual capital requirement of the project; Provided that the total equity requirement of 25% is complied with on the first year of ITH availment.
IV. LOCATIONAL POLICY

A. Regional Dispersal of Industries

The dispersal of economic activities to the countryside is encouraged.

Projects in any of the identified less developed areas (LDAs) listed in Annex A shall be entitled to pioneer incentives and additional deduction from taxable income equivalent to 100% of expenses incurred in the development of necessary and major infrastructure facilities unless otherwise specified in the Specific Guidelines.

B. Locational Restriction in NCR

The BOI shall limit incentives to firms that locate in congested urban centers. The locational restriction applies to the National Capital Region (NCR) wherein projects are not entitled to ITH. Exemption from the above locational restriction, however, may be given to the following:

1. Projects in government industrial estates\(^{13}\) declared by national law or presidential proclamation prior to 01 January 1989 (unless subsequently privatized)
2. Projects that will engage in service type activities
3. Expansion of export-oriented projects
   a. Expansion shall be effected within the firm’s existing premises.
   b. The enterprise has a good track record of exports and has no record of violation of the terms and conditions governing its existing registration(s), specifically, the earlier project exceeded its projected export commitment in the past three (3) years.
4. Modernization projects
5. Strategic Activities as defined under this IPP (see Part III, I.11 “Strategic Activities”)

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\(^{13}\) Government Industrial Estates
a) Dagat-Dagatan (P.D. No. 569 dated 30 October 1974)
c) Bagong Silang Industrial Estate, Caloocan City [Presidential Proclamation No. 843 dated 26 July 1971]
d) Food Terminal Inc., Taguig (LOI No. 900 dated 25 July 1979)
e) Navotas Fishing Port Complex (E.O. No. 772 dated 08 February 1982)
V. EXPORT OF PRODUCTS IN SHORT DOMESTIC SUPPLY

The export commitment of a registered enterprise may be suspended to satisfy national interest or in an emergency situation.

VI. ITH AVAILMENT

A. General Rules

1. In the grant of incentives, the Board shall give priority to projects with substantial benefits to the economy. In this regard, the extent of the project’s ITH entitlement shall be based on the following parameters: (1) project’s net value added, (2) job generation, (3) multiplier effect, and (4) measured capacity.

In the event that the registered enterprise fails to implement the project as represented in its project application, the Board may opt to reduce the project’s ITH availment proportionate to the actual performance (e.g. investments, employment generation, production and sales, timetable) of the enterprise.

2. The income qualified for ITH shall be limited to the income directly attributable to the revenue generated from the registered project.

3. Net income qualified for ITH availment shall not be a result of gross revenues exceeding 10% of the projected gross revenue represented by the firm in its application.

In cases where the project’s actual revenues exceed the projections in its application due to, e.g., new markets/orders, additional employment/shifts, additional investments, the Board may increase the project’s ITH availment proportionately. Request/s for adjustments of projected revenue must be filed before the filing of application for ITH.

4. In case of projects intended for own use, ITH shall only be applicable to revenues on sales generated or services rendered to other enterprises.

5. Only net income from operation of registered activity as certified under oath by CEO or CFO shall be entitled to ITH.

6. Enterprises with multiple registrations with the Board and/or several activities (whether BOI-registered or not) shall submit a list of cost items that are common with the qualified project and their cost allocation methodology for the said cost items, to ensure proper, fair and equitable allocation of common cost such as overhead and administrative costs.
B. Base Figure and Rate of Exemption

In general, ITH of expansion projects are subject to a base-figure equivalent to the enterprise’s highest sales volume in case of homogenous products or sales value in case of heterogeneous products, in the last three (3) years, prior to the filing of the application for registration of the project.

Projects registered under the modernization program without increase in capacity may be entitled to three (3) years ITH and other incentives without prejudice to compliance with other requirements. The computation of ITH for projects without increase in capacity is as follows:

For single product/activity:

\[
\text{Rate of Exemption (ROE)} = \frac{\text{New Investment (in US$)}}{\text{Total Investments (replacement cost + new) Relative to the concerned plant (in US$)}} \times 100
\]

For multiple products/activities or when ITH entitlement of other products/activities has lapsed:

\[
\text{% Sales Entitled to ITH} = \frac{\text{Sales of the Product subject of retooling}}{\text{Total Sales}} \times 100
\]

\[
\text{ROE} = \frac{\text{New Investment (in US$)}}{\text{Total Investments (replacement cost + new) Relative to the concerned plant (in US$)}} \times 100
\]

Where:

- ROE shall be fixed for the ITH entitlement period.
- Exchange rate shall be the existing rate at the time of actual investment or time of availment of ITH whichever will result in lower rate of ITH.
- Replacement cost shall refer to the appraised value of its Fixed Assets relative to the concerned plant in the first year of ITH availment duly assessed and certified by an Independent Appraiser. This shall thereon be used as a basis in succeeding ITH availments until the end of the ITH entitlement period of the project.
- % Sales Entitled to ITH shall be based on actual sales values for the year of availment.
C. Projects with Government Guarantee

Projects with government guarantee/subsidy are not entitled to ITH except in cases where ITH has been considered in the grant of rates approved by the regulatory agency concerned.

The ITH is deemed to have been imputed in the grant of the government guarantee/subsidy if the ITH was incorporated in the bid documents of the project proponent/contract with government on the project, or the ITH was included in the financial model by the regulatory agency in approving the project’s tariffs/rates. In the latter case, the availment of ITH shall be subject to a certification by the concerned regulatory agency.

VII. MULTI-PHASE PROJECTS

Projects of an enterprise with multiple phases/locations may be registered on a per phase/location.

VIII. CORPORATE SOCIAL RESPONSIBILITY (CSR)

BOI registered entities, recognizing the benefits derived from the fiscal incentives granted by the government, should endeavour to undertake meaningful and sustainable CSR projects in the locality where the projects are implemented.

Enterprises engaged in housing projects, when undertaking CSR activities, must establish facilities (e.g., community centers, child care centers, etc.) for the benefit of the homeowners within the housing project.

IX. GOOD CORPORATE GOVERNANCE

BOI registered enterprises must be committed to the tenets of Good Corporate Governance. Boards must function properly in decision making processes that affect their stakeholders.
X. SUPPORT TO ENVIRONMENTAL PROTECTION AND CONSERVATION

Registered enterprises shall adopt measures intended to reduce climate change risks in support of the National Framework Strategy on Climate Change.

New and expansion projects shall be required to secure an Environmental Compliance Certificate pursuant to P.D. No. 1586 (Philippine Environmental Impact Statement System) and other clearances under relevant environmental laws.

A Certificate of Non-Coverage (CNC) issued by the Environmental Management Bureau (EMB) shall be submitted for projects that are not critical to the environment.

Registered projects are encouraged to participate in the Philippines’ Eco-labeling Program (ELP), when applicable.

Registered enterprises are encouraged to secure environmental certifications based on internationally-recognized standards.

XI. INTERNATIONAL STANDARDS CERTIFICATION

Registered projects shall obtain applicable certifications based on internationally-recognized standards such as a Hazard Analysis and Critical Control Points (HACCP), ISO certification, quality standards (e.g., ICC, CE) or other similar certifications.

XII. EQUIPMENT

Registered enterprises shall use brand new equipment except for projects utilizing consigned equipment, projects involving transfer of facilities, and when specified in the Specific Guidelines, and apply production processes that meet environmental standards. Application for availment of capital equipment incentive shall be filed prior to the ordering of equipment.

XIII. PROJECTS IN THE AUTONOMOUS REGION IN MUSLIM MINDANAO (ARMM)

The ARMM List covers priority activities that have been identified by the Regional Board of Investments of the ARMM (RBOI-ARMM) in accordance with
E.O. No. 458. The RBOI-ARMM may also register and administer incentives to activities in this IPP for projects locating in the ARMM.

Projects in the ARMM should register with the BOI-ARMM.

XIV. PROJECTS WITH REVENUES DERIVED FROM CARBON CREDITS PURSUANT TO THE KYOTO PROTOCOL

Revenues from the sale of carbon credits through certified emission reduction (CER) units generated from registered activity may be considered as part of the income entitled to ITH, provided that the enterprise made representation at the time of application for registration that such projects would earn CER units.

Projects with foreign exchange earnings generated from CER units of more than 50% of their total revenues may be registered as export-oriented projects.

XIV. OUTSOURCING OF PRODUCTION PROCESS OR SERVICES

Portion/s of the production process or services of the registered activity may be outsourced provided that the core activity or the integrated nature of operation is undertaken by the registered enterprise.

XV. PUBLIC WELFARE CONSIDERATION

The BOI may deny applications for registration and/or grant of incentives for reasons of public health or morals or for environmental considerations.
Part III
SPECIFIC GUIDELINES

I. PREFERRED ACTIVITIES

1. Agriculture/Agribusiness and Fishery

This covers commercial production and commercial processing of agricultural, herbal and fishery products (including their by-products and wastes).

This also covers agriculture- and fishery-related activities such as irrigation, post harvest, cold storage, blast freezing, and the production of fertilizers and pesticides.

a. Commercial production

This covers the production of agricultural (crops, poultry and livestock) and fishery products.

In general, crop production should involve new plantation areas to qualify for registration.

This also covers intercropping of high value crops as identified by the Department of Agriculture (DA).

b. Commercial processing

This covers the conversion of agricultural and fishery products, their by-products and wastes, to a form ready for further processing or final consumption.

This also covers the extraction of higher value substances from agricultural and forest-based raw materials through bioprocessing as endorsed by the concerned government agency.

This also covers the production of animal and aqua feeds excluding those for game animals, fowls and other species for pet/leisure purposes.

Processing of agricultural products should involve domestically produced raw or semi-processed agricultural products, unless the raw or semi-processed raw materials are not locally produced (NLP) or not in sufficient quantity (NISQ).
If using imported raw or semi-processed agricultural products that are locally produced (LP) or in sufficient quantity (ISQ), the project may qualify for registration, provided that the finished/final product is for export, or the project qualifies for pioneer status.

c. Services in Support of Agriculture / Agribusiness and Fishery

- **Irrigation**

  This covers irrigation system primarily intended to render service to agricultural farms.

  Irrigation system shall include water source, distribution lines and control mechanism. The system may also include prime mover, pump, generator and transformer. System capacity is expressed in terms of cubic meters of irrigation water per year.

  Only revenues generated from services rendered to other agricultural farms may be entitled to ITH.

- **Harvesting Services**

  This covers mechanized harvesting services.

- **Post Harvest Facilities**

  This covers the establishment and operation of cold storage, freezing, bulk handling, packing house, storage facilities and trading centers.

  Only revenues generated from services rendered to other agricultural enterprises may be entitled to ITH.

Projects that cost at least the Philippine peso equivalent of USD200,000 may be granted pioneer status. Applications for registration must be endorsed by the concerned agency, when applicable.

2. Creative Industries/Knowledge-Based Services

This covers business/knowledge processing.

This also covers non-voice business processing operations, creative and knowledge-based services. Non-voice business process operations include the undertaking of outsourced services such as administrative and business services, transcription services, engineering and architectural services.
Creative industries/knowledge-based services with original content such as but not limited to software development, animation, engineering and architectural design, product design, game and applications development and software development; may be granted pioneer status provided that the project cost is at least the Philippine Peso equivalent of USD200,000 (excluding cost of land and building) to be put up during the first year of operations.

All ICT projects shall install internal security system compliant with BS 7799 or its equivalent.

3. Shipbuilding
This covers the construction and repair of ships/boats, shipbreaking and ship recycling. The following are the qualifications for registration:

General Requirements:
- Registered enterprises must have the minimum required paid-up capital, capital equipment and technical and skilled manpower as specified by Maritime Industry Authority (MARINA).
- Registered enterprises must comply with DOLE Department Circular No. 1 series of 2009 on the Guidelines on Occupational Safety and Health in Shipbuilding, Ship Repair and Shipbreaking Industry and secure a copy of Department of Environment and Natural Resources (DENR) issued Environmental Compliance Certificate (ECC).

Requirement for Ship/Boatbuilding:
- Ships/boats to be built must be at least 500 GT

Requirements for Shipbreaking/Ship recycling:
- Must have a drydocking or dismantling slip with a minimum capacity of 1,500 DWT
- Must comply with the requirements of the Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships including the preparation of a Ship Recycling Facility Plan and the Technical Guidelines for the Environmentally Sound Management of the Full and Partial Dismantling of Ships.

Any of the following may qualify for pioneer status:
- Shipbuilding or ship repair facilities with a minimum lifting capacity of 20,000 DWT
• Shipbuilding or ship repair facilities with a minimum berthing capacity of 7,500 DWT

• Projects that cost at least the Philippine Peso equivalent of US$100 million may be granted pioneer status.

Registered enterprises may be required to submit a copy of its License/Authorization or its equivalent from the MARINA or other concerned agency prior to start of commercial operation.

4. Mass Housing

This covers the development of low-cost mass housing. This also covers the manufacture of modular housing components preferably using indigenous materials.

The following are the qualifications for registration:

General requirements:

• The selling price of each housing unit shall be more than PhP400,000 but not exceeding PhP 3.0 million.

• Must be new or expanding low-cost mass housing project

• Minimum of twenty (20) livable dwelling units in a single site or building

• Project shall conform with the design standards set forth in the Rules and Regulations to Implement B.P. No. 220/P.D. No. 957 and other related laws.

• All low-cost mass housing projects must comply with the socialized housing requirement by developing an area for socialized housing equivalent to at least 20% of the total subdivision area or total subdivision project cost for horizontal housing and 20% of the total floor area of qualified saleable low cost housing units for vertical housing projects.

This may be done through any of the following modes:

• Development of a new settlement directly undertaken by the registered entity;

• Development of a new settlement through joint venture arrangements with either: a Local Government Unit, a Non-Government Organization accredited by the BOI, the National Housing Authority, a subsidiary of the BOI-registered entity, or a developer accredited by the HLURB.
In the case of joint venture projects, the BOI registered entity shall be required to provide proof of funds transferred to the implementing entity.

- Slum upgrading or renewal of areas through zonal improvement programs or projects that will directly address the problem of informal settlers along the main river systems.

Compliance with the socialized housing requirement must be completed within the ITH availment period and should be proportionate to the number of low-cost housing units being applied for ITH for the taxable year.

**Requirement for horizontal housing projects:**

- Mass housing projects must be located in areas zoned and classified for residential use/purposes in conformity with the approved Comprehensive Land Use Plan and Zoning of the concerned LGU.

**Requirement for vertical housing projects:**

- At least 51% of the total floor area, excluding common facilities and parking areas, must be devoted to housing units

- In lieu of the modes for compliance with the socialized housing requirement mentioned above, donation may be allowed. The option to donate is allowed provided: (1) the donation is made to BOI accredited NGO and (2) the amount to be donated shall be equivalent to 30% of (20% of the building construction cost based on the actual number or equivalent total floor area of qualified saleable low cost housing units) or not less than 40% of the estimated ITH. Equivalent total floor area refers to the sum total of the floor area of all the registered low-cost mass housing units.

Any of the following may be considered as an expansion project:

- Unfinished projects, the construction of which had stopped for at least one (1) year. Only the unsold units may qualify for registration

- Conversion to low-cost or socialized housing project of a building originally intended for commercial, office spaces, or exclusive condominiums

- Construction of additional floors or annexes intended for mass housing units
A project shall be considered as an expansion if it will locate adjacent or contiguous to an existing mass housing project owned by the same entity and shall share common facilities with the existing project.

Projects that have already been completed and have incurred sales (booked sales) of housing packages shall, in general, not qualify for registration.

In general, eligible projects in NCR, Metro Cebu and Metro Davao shall be entitled to three (3) years ITH.

In cases of un-incorporated joint venture and similar arrangements between land owner and developer wherein the sharing scheme is in terms of the number of lots or units built, only the share of the developer may qualify for registration.

Interest income arising from in-house financing shall not be entitled to ITH.

**Modular housing components**

This covers the manufacture of modular housing components preferably using indigenous materials. These include roof/framing systems, wall/partition systems, flooring systems, door/window systems, and finishing/ceiling systems.

The firm shall sell at least 50% of total annual production to mass housing projects.

5. **Iron and Steel**

This covers basic iron and steel products, long steel products (billets and reinforcing steel bars), and flat hot/-cold-rolled products.

Basic iron products include refined iron ore and primary steel products.

This also covers the manufacture of flat products, long products and fabrication of machinery, equipment and implements.

All iron and steel products must be compliant with the applicable Philippine National Standards (PNS) or International standards.

Projects that cost at least the Philippine Peso equivalent of US$500 million may be granted pioneer status.
6. **Energy**
   
   This covers the exploration, development, and/or utilization of energy sources adopting environmentally-friendly technologies.

   Only power plants utilizing environmentally-friendly energy sources and technologies may qualify for ITH.

   Projects that would utilize raw materials or semi-processed raw materials that are not locally produced (NLP) or not in sufficient quantity (NISQ) are exempt from NVA requirement.

   Only projects that have achieved financial closing for the project are qualified to apply for registration.

   Any of the following may qualify for pioneer status:

   - Power supply projects located in missionary areas or off-grid areas that are not receiving subsidies from PSALM;
   - Projects that cost at least the Philippine Peso equivalent of US$1.5 million per megawatt;
   - Projects with NVA of at least 30%

   For power generation projects, only revenues from power generated and sold to the grid, other entities and/or communities may be entitled to ITH.

   Power projects that are built contiguous to existing generating facilities shall be considered as expansion projects. However, if the existing base load plant has consistently dispatched at least 80% of their registered capacity for the past 3 years, the project to be registered may be considered new.

   The amount of ITH to be granted shall not exceed 10% of the total revenue of generated power.

   Applications for registration must be endorsed by the Department of Energy.

7. **Infrastructure**
   
   This covers transport, water, logistics, waste management facilities, physical infrastructure (tollways, railways and telecommunication facilities) and PPP projects.
a. **Transport**

This covers air, water and mass rail transport.

**(1) Air Transport**

Air transport operation includes passenger and/or cargo operation for commercial purposes.

Lease with option to purchase an aircraft may be allowed. Pure lease may be allowed provided that the lease contract is for a minimum of five (5) years.

Acquisition of additional aircraft/s may be registered as new.

Aircraft/s must not be more than 14 years old from date of production to the date of filing the application.

Any of the following may qualify for pioneer status:

- Projects serving the missionary/developmental routes, as indicated in the Certificate of Public Convenience and Necessity (CPCN) may qualify for pioneer status.

- Projects involving purchase/lease purchase of brand new aircraft. For lease purchase, the option to purchase should be exercised before the end of the 4th year of ITH availment.

All applications for registration must be endorsed by the Civil Aeronautics Board (CAB), when applicable. Such endorsement must contain information on the routes to be served.

Prior to start of commercial operation of each aircraft, the registered enterprise must submit a Certificate of Airworthiness issued by Civil Aviation Authority of the Philippines (CAAP).

**(2) Water Transport**

This covers domestic and overseas shipping.

**(a) Domestic/inter-island shipping**

This covers pure cargo, passenger, and passenger-cargo vessel operations including RORO Terminal System operations.

The following are the qualifications for registration:

- Must be a Philippine shipping enterprise accredited with the MARINA
• Vessel must be registered and operated under the Philippine Flag

• Must comply with following age requirements:

<table>
<thead>
<tr>
<th>Type of Vessel</th>
<th>Maximum Age from Original Date of Launching</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tankers</td>
<td>10 years</td>
</tr>
<tr>
<td>High-speed Craft</td>
<td>5 years</td>
</tr>
<tr>
<td>Passenger/Cargo</td>
<td>15 years</td>
</tr>
</tbody>
</table>

The age of the vessel shall be reckoned from the ship’s date of launching based on the Builder’s Certificate of Vessel Registry and must be complied with at the time of application.

• Tankers, High-speed Craft, RORO Vessels serving primary routes and Passenger/Cargo vessels must have gross weight of 150 GT and above.

• Tankers must be double-hulled.

RORO operator/enterprise serving missionary routes, as indicated in the Certificate of Public Convenience (CPC) issued by MARINA, may qualify for pioneer status.

(b) Overseas shipping

The following are the qualifications for registration:

• Must be a Philippine shipping enterprise accredited with the MARINA

• Vessel must be registered and operated under the Philippine Flag

• Vessels must be at least 1,000 GT and must not be more than fifteen (15) years old

Acquisition of brand new vessels may qualify for pioneer status. Acquisition of additional vessel/s may be registered as new project.
Lease or charter of foreign-owned vessel with option to purchase may be allowed. Pure lease or bareboat charter may be allowed provided the lease contract is for a minimum of one (1) year; Provided further, that any replacement of vessels shall be covered by the enterprise’s existing registration involving the leased vessel, which shall be valid for at least one (1) year.

All vessels must be seaworthy and must obtain valid Class and Statutory Certificates as required by MARINA.

Modernization of ships may be allowed with entitlement to ITH limited to investments in safety and navigation devices and equipment.

All applications for registration must be endorsed by the MARINA.

b. Water Supply and/or Distribution

This covers bulk supply projects and new or upgrading of water distribution systems.

Applications covering both supply and distribution projects shall be unbundled showing the revenue and cost structure of each.

In cases of upgrading of existing projects, only revenues that are derived from incremental volume shall be eligible for ITH.

Supply of water shall be limited to treated water and should be in accordance with the Philippine National Standard for Drinking Water.

Distribution activity should include extraction of water, treatment and installation of distribution lines and flow metering systems.

A copy of the Water Permit and/or Certificate of Public Convenience must be submitted.

Projects involving any of the foregoing areas of water operations dedicated to a particular industrial estate, industrial community, or subdivision are not qualified for registration under this listing.
c. Logistics

This covers ports, terminals (passenger/intermodal terminals, cargo terminals/container yards, LNG/CNG storage terminals, natural gas refueling stations and charging stations for electric vehicles), warehouses and relocation of oil terminals.

(1) Ports

This covers the development and operation of airports and seaports.

All applications for registration must be endorsed by the CAAP or the Philippine Ports Authority (PPA), whichever is applicable.

(2) Terminals

(a) Passenger/Intermodal terminals

The following are the qualifications for registration:

- Must cater to shipping lines or airlines and/or different land transportation systems (rail system, buses, taxis, etc.);
- Must have new facilities with parking, comfort rooms, ticketing and reservation office, air-conditioned waiting area and provide shuttle services; and
- Must have a system of ingress and egress to prevent traffic buildup/obstruction of thoroughfares on a 24-hour basis as certified by DOTC, Metropolitan Manila Development Authority (MMDA) and/or other concerned agency.

Bus terminals that will integrate all bus lines operating within a particular municipality or city shall be eligible for registration. The facilities shall have ample parking spaces, comfort rooms and waiting areas. Projects of this nature undertaken in highly urbanized cities shall be granted pioneer status.

(b) Cargo terminals/Container yards

The following are the qualifications for registration:

- Must have new facilities; and
- Must have a system of ingress and egress to prevent traffic buildup/obstruction of thoroughfares on a 24-hour basis as certified by DOTC, MMDA and/or other concerned agency.
(c) LNG/CNG storage, distribution and marketing

This covers the establishment and operation of storage, distribution and marketing facilities for the bulk handling/sale of natural gas in accordance with relevant Philippine National Standards (PNS).

This also covers the establishment and operation of natural gas refueling station and related infrastructures and facilities in accordance with relevant Philippine National Standards. Foreign-owned stations must comply with the Retail Trade Law (R.A. No. 8762)

For marketing, distribution and refueling stations, the registered enterprise must submit a copy of its Permit to Operate and Supply Natural Gas issued by the DOE prior to start of commercial operations.

For storage, the registered enterprise must submit a copy of its Permit to Operate issued by the DOE prior to start of commercial operation.

The following are the qualifications for registration for storage, marketing and distribution:

- Must have new facilities;
- Must cater to power plants, industrial plants, shipping vessels, commercial establishments or land transport; and
- Must cater to at least one (1) clientele, other than the proponent’s own business.

Projects that cost at least PhP1 billion may be granted pioneer status.

(d) Charging stations for electric vehicles

This covers the establishment of charging stations for electric vehicles. The charging stations could refer to a ‘service station’ designed to simultaneously fast charge multiple vehicles similar to gasoline/diesel stations or a network of at least 5 charging stands.

All applications for registration must be endorsed by concerned agency.
(3) Warehouses

This covers the establishment of automated warehousing facilities with automated retrieval systems, conveyors, cranes and other cargo handling equipment.

Distribution or Fulfillment Centers with at least 50% of its revenues derived from serving other countries shall be granted Pioneer status.

Only revenues generated from services rendered to other enterprises may be entitled to ITH.

(4) Relocation and putting up of a new oil terminal

Projects that cost at least PHP1 billion may be granted pioneer status.

All applications for registration must include a DOE endorsement and proof of the project’s compliance with appropriate land use/zone plans including safety and security measures prescribed by the local government unit (LGU)/agency that approved the same.

d. Waste Management Facilities

This covers the establishment of toxic and hazardous waste (THW) treatment facilities.

The following are the qualifications for registration:

- Must involve treatment, storage and disposal (TSD)
- Must be capable of handling THW
- Must handle only locally-generated wastes.

Prior to start of commercial operation, the registered enterprise must submit a copy of its TSD Registration Certificate issued by the Environmental Management Bureau (EMB) of the DENR. If handling radioactive wastes, the registered enterprise must submit a License to Operate a Radioactive Waste Management Facility from the Philippine Nuclear Research Institute (PNRI) of the Department of Science and Technology (DOST) in addition to the TSD Registration Certificate.

e. Physical Infrastructure

This covers tollways, railways and telecommunication facilities.
(1) Tollways and railways

This covers the development, including rehabilitation, upgrading, and/or expansion, and/or operation of tollways and railways.

Upgrading of existing physical infrastructure may be registered as a new project provided that the cost of upgrading already approximates at least 90% of the prevailing cost of constructing a new physical infrastructure, as certified by the concerned agency.

If the cost of upgrading of the physical infrastructure is less than 90% of the prevailing cost of constructing a new physical infrastructure, the project may be registered as a modernization activity but not entitled to ITH.

For projects that will involve the development and operation of physical infrastructure to be undertaken by separate entities, both the developer and operator may qualify for registration. However, the developer may be entitled only to incentive on capital equipment directly needed for the operation of the physical infrastructure.

(2) Telecommunication infrastructure

This covers the establishment of new telecommunications infrastructure in the provinces particularly in the rural areas as endorsed by the National Telecommunications Commission (NTC) and utilizing at least fiber optic technology.

Projects that cost at least the Philippine Peso equivalent of US$100 million may be granted pioneer status.

f. PPP Projects

This covers projects under the Public-Private Partnership ("PPP") Program of the government.

Applications must be endorsed by the PPP Center or other concerned government agency/unit.

8. Research and Development

This covers R&D activities and the establishment of research/testing laboratories, Centers of Excellence (COE) and technical vocational education and training institutions.
a. Research and Development

This covers all R & D activities including the establishment of research/testing laboratories (e.g., for pharmaceuticals, electronics, construction, etc.).

This also covers the establishment and operation of facilities for the conduct of clinical trials (e.g., Clinical Research Organization or CRO). The registered CRO must submit a copy of Permit for Clinical Investigational Use (PCIU) issued by Food and Drugs Administration (FDA) before the conduct of each clinical trial.

Applications for registration must be endorsed by the DOST or other concerned agency, as may be deemed necessary.

b. Center of Excellence (“COE”)

This covers the establishment of entrepreneurial, technology, business incubation centers, common service facilities, and manufacturing, service and agribusiness entities including those locating in the premises of state universities and colleges (SUCs) outside Metro Manila and with a special arrangement with the SUC to develop competencies in entrepreneurship, and research and development.

c. Training/Learning Institutions

This covers the establishment of institutions specializing in the technical vocational education and training (e.g., engineering, culinary arts, etc.) in support of the activities listed in this IPP.

The following are the requirements for registration:

- The curriculum must be approved by either the Technical Education and Skills Development Authority (TESDA) for training courses or the Commission on Higher Education (CHED) for degree courses or other concerned government agencies/authority and endorsed by the appropriate industry association.

- The registered education/training/learning institutions must provide training laboratories and equipment, if applicable.

Projects that cost at least the Philippine Peso equivalent of USD2 million may be granted pioneer status.
9. Green Projects

This covers the manufacture/assembly of goods and the establishment of energy efficiency-related facilities (such as district cooling systems), where either utilization of which would significantly lead to either the efficient use of energy, natural resources or raw materials; minimize/prevent pollution; or reduce greenhouse gas emissions.

To qualify for registration, assembly operations must be integrated with the manufacture of at least one part/component for use in the assembly.

Green Projects covers only projects other than those already listed in this IPP.

10. Manufacture of Motor Vehicles

a. Manufacture/assembly of motor vehicles

The project shall involve the manufacture/assembly of brand new motor vehicle units (excluding 2-stroke motorcycles) that are compliant with the prevailing national standards and regulations on the registration, use and operation of motor vehicles.

Any of the following may qualify as new:

1. Projects that will involve the establishment of a factory complete with production machinery/equipment and facilities such as welding section, assembly section, metal treatment section, painting section, testing facility for road worthiness and emission standard compliance, and pre-delivery inspection section.

2. Projects of an existing motor vehicle manufacturer/assembler that involves the production of a new model or a full model change shall be considered new project, provided there is new investments of at least PHP100 million for four-wheel vehicles and manufacture of parts and components, otherwise the project will be considered expansion.

Any of the following may qualify for pioneer status:

- Projects covered under paragraph a.1 above for manufacture/assembly of passenger cars and/or commercial vehicles with investments of at least USD50 million and for the manufacture/assembly of motorcycle with investments of at least USD4 million. Investments may include the cost of the acquisition of an existing assets or facilities.
Projects covered under paragraph a.2 above with investments of at least US$20 million for passenger cars and/or commercial vehicles, USD1.5 million for motorcycles

Projects on the manufacture/assembly of alternative fuel vehicle and electric vehicles. Alternative fuel vehicles include the following:

Hybrid vehicles are vehicles that run on electric batteries and gasoline/diesel/other fuels.

Electric vehicles are vehicles that run solely on electric power.

Flexible-fuel vehicles are vehicles that run on gasoline/diesel in combination with alternative fuel such as but not limited to:

- Bioethanol vehicles that run on gasoline and a minimum ethanol content/blend of at least 20%
- Biodiesel vehicles that run on diesel and a minimum biodiesel blend/content of at least 5%
- Compressed Natural Gas Vehicles are vehicles that run on Compressed Natural Gas (CNG)
- Other vehicles powered by LPG, fuel cell and other alternative fuels.

Manufacture/assembly of brand new three or four-wheel Philippine utility vehicles for cargos and/or passengers

b. Manufacture of parts and components

This covers the manufacture of motor vehicle parts and components either as original equipment manufacturer (OEM) or after-market products.

Any of the following may qualify for pioneer status:

- Manufacture of engines and transmissions
- Manufacture of tool & die to produce chassis and engine
- Establishment of common facility for heat treatment, forging, stamping of motor vehicle parts and components
- Production of electric motors, batteries other than lead acid batteries, controller assembly and battery charger for electric vehicles
11. Strategic Projects

This covers projects that exhibit very high social economic returns that will significantly contribute to the country’s economic development.

The social economic returns of the proposed project shall be measured in terms of the following:

- Consumer-based benefits (e.g., price, availability, quality)
- Forward and backward linkages with existing industries in the country
- Generation of at least 500 direct employment or use of highly-specialized or advanced technology
- Generation of at least USD1 million in foreign exchange savings, when applicable
- Stature of the proponent as a global player, when applicable

Notwithstanding the preceding paragraphs, manufacture of packaging products that will involve product or process innovation which shall lead to significant improvements in quality and value of the packaged products shall also be deemed as “Strategic Project.” Likewise, the manufacture of essential drugs and medicines as listed in the Philippine National Drug Formulary (PNDF) shall be deemed as “Strategic Project”.

Projects that cost at least the Philippine Peso equivalent of US$500 million may be granted pioneer status.

Projects under these activities will be approved upon determination by the Board in consultation with the Department of Finance (DOF), National Economic Development Authority (NEDA) and other appropriate government agencies.

12. Hospital/Medical Services

This covers the establishment and operation of medical facilities including primary, secondary, tertiary hospitals and ambulatory facilities.

Only revenues from the provision of medical and diagnostic services shall be entitled to ITH. Revenues from operating a pharmacy, food services and any other non-treatment related services will not be eligible for ITH.

Secondary care hospitals with a minimum capacity of 50 beds and an investment cost of at least the Philippine Peso equivalent of US$2.5 million may qualify for pioneer status.
Only facilities outside of Metro Manila may qualify for registration.

Prior to availment of ITH, registered projects must submit copies of license to operate issued by the DOH and Philhealth Accreditation.

12. Disaster Prevention, Mitigation and Recovery Projects

a. This covers projects that will prevent or mitigate adverse impacts of calamities and disasters, which may include installation of flood control systems; installation of early warning systems for typhoons, earthquake occurrences, tsunami and volcanic eruptions; manufacture or assembly of goods critical to disaster management; construction of dikes; and salvaging operations.

These include the manufacture and assembly of equipment and goods that will be used for disasters, calamities and emergencies, the provision of rescue and retrieval services, the provision of information services relate to disaster management, the provision of specialized equipment and services needed to restore vital public services in a fast and efficient manner, the provision of training services for first responders and any other activity that will contribute to the goals of mitigating risks to public safety caused by disasters, calamities and emergencies.

Salvaging pertains to the rescue of a seriously damaged/incapacitated ship that may include refloating and towing of the ship to a safe place. It also pertains to the removal of a sunken or wrecked ship, derelict or hazards including cargoes thereof.

Only income from salvaging operations (excluding income from artifacts/treasure recovered from sunken vessels/ships) may be entitled to ITH.

b. This also covers projects to rehabilitate areas affected by calamities and disasters, which may include rebuilding of roads and bridges after earthquakes/flooding, volcanic eruptions, and oil spill clean-up.

For projects that will involve the development and operation of physical infrastructure to be undertaken by separate entities, both the developer and operator may qualify for registration. However, the developer may be entitled only to incentive on capital equipment directly needed for the operation of the physical infrastructure.

c. This further covers training for disaster preparedness, mitigation or recovery/rehabilitation/reconstruction.
All applications for registration must be endorsed by concerned agency. Projects that cost at least the Philippine Peso equivalent of USD100,000 may be granted pioneer status. Disaster Prevention, Mitigation and Recovery Projects covers only projects other than those already listed in this IPP.

II. MANDATORY LIST

1. Industrial Tree Plantation
   This covers extensive plantation of forest land of tree crops (except fruit trees) for commercial and industrial purposes.

   Tree crops include timber and non-timber species such as rubber, bamboo, rattan, etc. (excluding fruit trees) for commercial and industrial purposes.

   Each Industrial Tree Plantation (ITP) project must have an approved and issued forest management/development agreement such as:
   - Socialized Industrial Forest Management Agreement (SIFMA)
   - Industrial Forest Management Agreement (IFMA)
   - Private Forest Development Agreement (PFDA)
   - Community-based Forest Management Agreement (CBFMA)

   In cases of tree plantations that are joint venture agreements with other private entities, community organizations or government entities, only the share of the registered enterprise may be entitled to ITH.

2. Exploration, Mining, Quarrying and Processing of Minerals
   This covers the exploration and development of mineral resources, mining/quarrying and processing of metallic and non-metallic minerals.

   Exploration of mineral resources including those covered by valid and existing exploration permits or mineral agreements may qualify for pioneer status.

   Mining and mineral processing projects are not entitled to ITH.

3. Publication or Printing of Books/ Textbooks
   This covers printing, re-printing, publication and content development of books or textbooks.

   Application for registration shall be on a per book or title basis and must be endorsed by the National Book Development Board (NBDB).
4. Refining, Storage, Marketing and Distribution of Petroleum Products

This covers refining, storage, distribution, and marketing of petroleum products.

For gasoline retailing stations, except those locating in LDAs listed in this IPP, the applicant shall be required to invest a minimum capital of PhP10 million per station, excluding land, or such amount as may be determined jointly by BOI and DOE for augmentation purposes, as the need arises; Provided, that foreign retailers shall comply with the requirements provided under R.A. No. 8762, otherwise known as the Retail Trade Liberalization Law, and its implementing rules and regulations.

For storage, marketing and distribution, only investments of new industry participants may be entitled to incentives. The applicant shall submit an endorsement from the DOE certifying that the applicant is a new industry participant with new investments.

For storage, marketing and distribution, petroleum products excluding liquefied petroleum gas (LPG), shall be sourced from the new industry participants as defined under R.A. No. 8479, except in cases of emergency supply situation.

For projects that involve more than one activity, i.e., storage, marketing and distribution, each must be unbundled showing the revenue streams and costs for each activity.

Blending of petroleum products alone may only be entitled to capital equipment and other non-fiscal incentives.

Applicant enterprises shall elect to be governed by the provisions of E.O. No. 226 or R.A. No. 8479 at the time of their application for registration, provided that such election once made shall be final.

5. Ecological Solid Waste Management

This covers the establishment of waste recycling facilities whether or not integrated with manufacturing facility, using as inputs 100% locally generated solid waste materials or scraps from the recycling facility to produce semi-finished or finished product.

This also covers the establishment of an integrated solid waste management facility that includes the following: 1) materials recovery facility with a processing center that shall be used to manufacture goods from recyclable wastes (biodegradable, non-biodegradable, recyclable and residual) as the raw materials; and 2) categorized sanitary landfill that shall accommodate only residual wastes that were not recycled due to the absence of appropriate technology for recycling.
Waste recycling projects without a manufacturing/processing facility are not entitled to ITH.

Registered projects may avail of capital equipment incentive.

All applications for registration must be endorsed by the Environmental Management Bureau of DENR.

6. Clean Water Projects
This covers the establishment of wastewater treatment facilities and sewage collection integrated with treatment facilities and the adoption of water pollution control technology, cleaner production and waste minimization undertaken through BOT or non-BOT schemes.

Activities such as 5S and Good Housekeeping are not qualified for registration.

Wastewater treatment facilities and sewage collection integrated with treatment facilities may be entitled to ITH.

Projects adopting water pollution control technology, cleaner production and waste minimization are only entitled to capital equipment incentive.

All applications for registration must be endorsed by the DENR, the Laguna Lake Development Authority (LLDA) or other concerned agency.

Projects that will employ new or proprietary technologies shall submit an Environmental Technology Verification (ETV) issued by the DOST.

7. Rehabilitation, Self-Development and Self-Reliance of Persons with Disability
This covers the manufacture of technical aids and appliances for the use and/or rehabilitation of persons with disability, and the establishment of special schools, day care centers, homes, residential communities or retirement villages solely to suit the needs and requirements of persons with disability.

Manufacturing of technical aids and appliances used by persons with disability includes but is not limited to the following:

- Walk-in baths designed for persons with disabilities
- Commode chairs
- Braille books
- Hoists and lifting chairs designed for incapacitated people, including stair lifts
8. Renewable Energy
This covers developers of renewable energy facilities, including hybrid systems.

This also covers manufacturers, fabricators and suppliers of locally-produced renewable energy equipment and components.

Sales of power generation projects with feed-in-tariffs (FIT) shall not be entitled to ITH unless the ITH was included in the financial model by ERC in approving the project’s power (FIT) rate.

Applications for registration must submit DOE Certificate of Registration, Certificate of Accreditation or DOE endorsement, whichever is applicable.

Applicant enterprises shall elect to be governed by the provisions of E.O. No. 226 or R.A. No. 9513 at the time of their application for registration. Under E.O. No. 226, RE projects may qualify for pioneer status.

9. Tourism
This covers tourism enterprises that are outside the tourism enterprise zones (TEZs) and are engaged in the following:

1. Tourist transport services whether for land, sea and air transport for tourist use;

2. Establishment and operation of:
   - Accommodation establishments such as but not limited to hotels, resorts, apartment hotels, tourist inns, motels, pension houses, private homes for homestay, ecododges, condotels, serviced apartments, and bed and breakfast facilities;
   - Convention and exhibition facilities or “meetings, incentives, conventions and exhibition” (MICE) facilities;
   - Amusement parks;
• Adventure and ecotourism facilities;
• Sports facilities and recreational centers;
• Theme parks;
• Health and wellness facilities such as but not limited to spas, tertiary hospitals, and ambulatory clinics;
• Agri-tourism farms and facilities; and
• Tourism training centers and institutes.

3. Development of retirement villages.

4. Restoration/preservation and operation of historical shrines, landmarks and structures.

1. Tourist transport

This covers transport services whether for land, water and air transport for tourist use.

Land transport covers the operation of brand new, world-class buses and/or minibuses/coasters. The quantity or number of units of vehicles that may be allowed shall be determined based on the number of tourist arrivals in the area or the ratio of hotel/resort facilities/rooms.

Tourist transport operators must have garage, hangar or berthing/docking facilities.

Applications for registration of water and air transport operators must be endorsed by MARINA or CAAP, respectively.

Registered tourist land transport operators must submit a copy of CPC.
2. Tourism-related facilities

(1) Accommodation facilities

Condotel/apartment hotel/serviced apartment/tourist inn/pension house/motel, must cater to tourists/guests to qualify for registration. Each unit must have fully equipped kitchen and laundry facilities.

Income arising from gaming and mall operations are not qualified for ITH.

For modernization projects, replacement of carpets, pillows, mattresses and other similar items shall be excluded from the computation of the ITH rate of exemption.

For hotels and resorts, the quantity or number of units of buses and/or minibuses/coasters that may be allowed shall be determined based on the number of tourist arrivals in the area or the ratio of hotel/resort facilities/rooms.

Any of the following may qualify for pioneer status:

- Hotel projects/apartment hotels/serviced apartments/condotels classified as first class or deluxe by the Department of Tourism ("DOT") and costing at least the Philippine equivalent of USD100,000/room

- Resort projects classified as “AAA” by the DOT and with project cost of at least the Philippine Peso equivalent of US$10 million

- Projects located in LDAs

- Modernization of hotels classified as first class or deluxe by the DOT with a project cost of at least the Philippine Peso equivalent of USD10,000/room

- Amusement parks/theme parks with minimum project cost of the Philippine Peso equivalent of USD10 million involving the development of sites or attractions considered as novel in the Philippines

- Adventure and ecotourism facilities/agri-tourism farms and facilities with a project cost of at least the Philippine Peso equivalent of USD5 million.
(2) Health and Wellness

(a) Health Spa

This covers the establishment and operation of destination spa, resort/hotel spa, therapeutic centers, traditional healing (e.g., Philippine “hilot,” “dagdagay,” “ventossa”, etc.), and other alternative healing and medical care services.

Projects that cost at least the Philippine Peso equivalent of USD20 million may be granted pioneer status.

(b) Tertiary Hospital

This covers tertiary hospitals with a minimum of (fifty) 50 rooms (suites and private rooms only) and with a minimum project cost of at least the Philippine peso equivalent of USD10 million.

(c) Ambulatory Clinics

This covers services such as elective (non-emergency) surgical treatment whether requiring local, regional or general anesthesia of out-patients whose recovery, under normal and routine circumstances, will not require in-patient care. This includes comprehensive ophthalmologic surgery, dermatology, cosmetic procedure, plastic and reconstructive surgery, cosmetic dentistry, and medical care (diagnosis, observation, treatment and rehabilitation).

Prior to start of commercial operation, the registered enterprise must submit a copy of its License to Operate from the Department of Health (“DOH”).

(3) Tourism Training Centers and Institutes

The following are the requirements for registration:

- The curriculum must be endorsed by the appropriate industry association and approved by either the TESDA for training courses or CHED for degree courses or other concerned government agencies/authority.

- The registered education/training/learning institutions must provide training laboratories/On-the-Job facilities and equipment.
All applications for registration must be endorsed by the Department of Tourism (DOT).

DOT accreditation must be submitted prior to ITH availment. Only income derived from tourism-related activities shall be entitled to ITH.

3. **Retirement Village**

The following are the qualifications for registration:

- A retirement village must have a minimum of four (4) hectares of contiguous land
- Project cost must be at least the Philippine Peso equivalent of US$10 million

Retirement villages with a minimum area of twenty (20) hectares may qualify for pioneer status.

Locators engaged in the activities listed in the IPP that are related to retirement business may be registered as separate activity.

Applications must be endorsed by the Philippine Retirement Authority (PRA). PRA accreditation must be submitted prior to ITH availment.

4. **Restoration/ preservation and operation of historical shrines, landmarks and structures.**

This covers the conservation, preservation or restoration of national sites or properties.

Projects undertaking the conservation and preservation, restoration or maintenance of historico-cultural heritage that includes any of the following may qualify for registration:

a. National shrines, monuments, and/or landmarks
b. Local historical sites/properties classified, identified, and listed in the National Registry of Historic Structures
c. Cultural properties, treasures and/or artifacts

Any of the following historic-cultural heritage projects may qualify for pioneer status:

- Residential projects with a project cost of at least PHP10 million, or
- Other structures with a project cost of at least PHP20 million.
III. EXPORT ACTIVITIES

This covers the manufacture of export products, services exports and activities in support of exporters.

A. Production and Manufacture of Export Products

This covers the production/manufacture of non-traditional export products and with export requirement of at least 50% of its output, if Filipino-owned or at least 70%, if foreign-owned.

Export products include electronics, garments and textiles (including brassieres, gloves and mittens, and infant’s wear), footwear and leather goods, furniture, jewelry, marine and aquaculture, mineral products and others.

In the export of mineral products, the Specific Guidelines for R.A. No. 7942 of this IPP shall apply suppletorily.

B. Services Exports

This covers service activities rendered to clients abroad and paid for in foreign currency with export requirement of at least 50% of its revenue, if Filipino-owned or at least 70%, if foreign-owned.

Mere deployment of people or individual practice of profession abroad is not qualified for registration.

For contact centers, project must have a minimum investment cost of the Philippine Peso equivalent of USD2,500 per seat to qualify for registration. This amount covers the cost of equipment (hardware and software), office furniture and fixture, building improvements and renovation, and other fixed assets except land, building and working capital. If equipment used were leased, the same should be converted to assets in terms of commercial interest rates and amortized over a five-year period. If equipment were consigned, the same should have an assigned value to be considered as part of the project cost.

In the case of contact centers, revenues shall be unbundled to show the breakdown of servicing domestic and overseas markets.
C. **Activities in Support of Exporters**

This covers activities directly supporting export producers as follows:

1. Manufacture of parts/components and materials and supplies directly/reasonably needed in the production of the export product;
2. Services comprising a portion of the manufacturing process;
3. Product testing and inspection;
4. Repair and maintenance; and
5. Logistics services

This also covers service providers to foreign film and television production projects in the country as endorsed by the Philippine Film Export Services Office (PFESO) as mandated by E.O. No. 674.
## ANNEX A

### LIST OF LESS-DEVELOPED AREAS (LDAs)

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ANNEX B

INCENTIVES FOR BOI-REGISTERED ENTERPRISES

Entitlement and availing of incentives shall be subject to the terms and conditions set forth under the relevant law and the project’s Certificate of Registration as well as the rules and regulations of the implementing/administering agency.

A. Omnibus Investments Code of 1987 (E.O. No. 226)

1. Income Tax Holiday (ITH)
   a. Six (6) years for projects with pioneer status and for projects located in a Less Developed Area (LDA)
   b. Four (4) years for new projects with non-pioneer status
   c. Three (3) years for expansion/modernization projects

2. Duty exemption on imported capital equipment, spare parts and accessories

3. Exemption from wharfage dues and any export tax, duty, impost and fees

4. Tax exemption on breeding stocks and genetic materials

5. Tax credits on imported raw materials

6. Tax and duty-free importation of consigned equipment

7. Additional deduction for labor expense

8. Employment of foreign nationals

9. Simplification of customs procedures

10. Access to bonded manufacturing warehouse
B. Revised Forestry Reform Code of the Philippines  
(P.D. No. 705)

Incentives under E.O. No. 226 or the following:

1. Treatment of the amounts expended by a lessee in the development and operation of an industrial tree plantation or tree farm prior to as ordinary and necessary business expenses or as capital expenditures; and

2. Deduction from an investor’s taxable income for the year, of an annual investment allowance equivalent to thirty-three and one-third per cent (33-1/3%) of his actual investment during the year in an enterprise engaged in industrial tree plantation or tree farm.

C. Philippine Mining Act of 1995 (R.A. No. 7942)

Incentives under E.O. No. 226 and the following:

1. Exemption from real property tax and other taxes or assessments of pollution control devices

2. Income tax-carry forward of losses

3. Income tax-accelerated depreciation

D. Book Publishing Industry Development Act  
(R.A. No. 8047)

Incentives under E.O. No. 226
E. Downstream Oil Industry Deregulation Act of 1998  
(R.A. 8479)

1. Income tax holiday (5 years)
2. Additional deduction for labor expenses
3. Minimum tax and duty of three percent (3%) and value-added tax (VAT) on imported capital equipment
4. Tax credit on domestic capital equipment
5. Exemption from contractor’s tax
6. Unrestricted use of consigned equipment
7. Exemption from the real property tax on production equipment or machineries;
8. Exemption from taxes and duties on imported spare parts
9. Such other applicable incentives under Article 39 of Executive Order No. 226.

F. Ecological Solid Waste Management Act of 2000  
(R.A. No. 9003)

1. Duty exemption on imported capital equipment, vehicles and spare parts
2. Tax and duty exemption of donations, legacies and gift
3. Non-fiscal incentives under E.O. No. 226

G. Philippine Clean Water Act of 2004  
(R.A. No. 9275)

1. Tax and duty exemption on imported capital equipment, vehicles and spare parts
2. Tax and duty exemption of donations, legacies and gift
3. Non-fiscal incentives under E.O. No. 226
H. Magna Carta for Disabled Persons (R.A. No. 7277)

Incentives under E.O. No. 226

I. Renewable Energy Act of 2008 (R.A. No. 9513)

1. Income tax holiday (7 years)
2. Duty-free importation of RE machinery, equipment and materials
3. Net Operating Loss Carry-Over (NOLCO)
4. Corporate tax rate of 10% after ITH
5. Accelerated depreciation
6. VAT- zero rate on sale of fuel or power generated
7. Cash incentive for missionary electrification
8. Tax exemption of carbon credits
9. Tax credit on domestic capital equipment and services

J. Tourism Act of 2009 (R.A. No. 9593)

Incentives under E.O. No. 226

These General Policies and Specific Guidelines shall take effect immediately upon publication.

By the Authority of the Board:

LUCITA P. REYES
Executive Director
Industry Development Group

***************NOTHING ELSE FOLLOWS***************
WHEREAS, Republic Act (RA) No. 7042, also known as the “Foreign Investments Act of 1991,” as amended by RA 8179, provides for the formulation of a Regular Foreign Investment Negative List, covering investment areas/activities which may be opened to foreign investors and/or reserved to Filipino nationals; and

WHEREAS, there is a need to formulate the Ninth Regular Foreign Investment Negative List, replacing the Eight Regular Foreign Investment Negative List, to reflect changes to List A pursuant to existing laws and upon recommendation of concerned agencies.

NOW, THEREFORE, I, BENIGNO S. AQUINO III, President of the Philippines, by virtue of the powers vested in me by law, do hereby order:

SECTION 1. Ninth Regular Foreign Investment Negative List. Only the investment areas and/or activities listed in the Annex hereof shall be reserved to Philippine nationals, and hereafter shall be referred to as the Ninth Regular Foreign Investment Negative List. The extent of foreign equity participation in
these areas shall be limited to the percentages indicated in the List.

SECTION 2. Amendments. Amendments to List A may be made at any time to reflect changes instituted in specific laws while amendments to List B shall not be made more often than once every two years, pursuant to Section 8 RA 7042, as amended, and its revised implementing rules and regulations.

SECTION 3. Repeal. All issuances, orders, rules and regulations, or parts thereof, which are inconsistent with this Executive Order are hereby repealed, amended or modified accordingly.

SECTION 4. Separability. If any provision of this Executive Order is declared invalid or unconstitutional, the other provisions not affected thereby shall remain valid and subsisting.

SECTION 5. Effectivity. This Executive Order shall take effect fifteen (15) days after its publication in a newspaper of general circulation.

DONE, in the City of Manila, this 29th day of October in the year of our Lord, Two Thousand and Twelve.

By the President:

PAQUITO N. OCHOA, JR.
Executive Secretary
ANNEX

NINTH REGULAR FOREIGN INVESTMENT NEGATIVE LIST

LIST A: FOREIGN OWNERSHIP IS LIMITED BY MANDATE OF THE
CONSTITUTION AND SPECIFIC LAWS

“List A: Foreign Ownership is Limited By Mandate of The
Constitution and Specific Laws”

No Foreign Equity

1. Mass media except recording [Art. XVI, Sec. 11 of the Constitution, Presidential
Memorandum dated 04 May 1994]

2. Practices of all professions [Art. XII. Sec. 14 of the Constitution, Sec. 1 of
RA 5181]

   a. Engineering
      i. Aeronautical engineering (PD 1570)
      ii. Agricultural engineering (RA 8559)
      iii. Chemical engineering (RA 9297)
      iv. Civil engineering (RA 1582)
      v. Electrical engineering (RA 7920)
      vi. Electronics and communication engineering (RA 9292)
      vii. Geodetic engineering (RA 8560)
      viii. Mechanical engineering (RA 8495)
      ix. Metallurgical engineering (PD 1536)
      x. Mining engineering (RA 4274)
      xi. Naval architecture and marine engineering (RA 4565)
      xii. Sanitary engineering (RA 1364)

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14 This is limited to Filipino citizens save in cases prescribed by law.
b. Medicine and allied professions
   i. Medicine [RA 2382 as amended by RA 4224]
   ii. Medical technology [RA 5527 as amended by RA 6138, PD 498 and PD 1534]
   iii. Dentistry [RA 9484]
   iv. Midwifery [RA 7392]
   v. Nursing [RA 9173]
   vi. Nutrition and dietetics [PD 1286]
   vii. Optometry [RA 8050]
   viii. Pharmacy [RA 5921]
   ix. Physical and occupational therapy [RA 5680]
   x. Radiologic and x-ray technology [RA 7431]
   xi. Veterinary medicine [RA 9262]

c. Accountancy [RA 9298]

d. Architecture [RA 9266]

e. Criminology [RA 6506]

f. Chemistry [RA 754]

g. Customs brokerage [RA 9280]

h. Environmental planning [PD 1308]

i. Forestry [RA 6239]

j. Geology [RA 4209]

k. Interior design [RA 8534]

l. Landscape architecture [RA 9053]

m. Law [Art, VIII. Section 5 of the Constitution, Rule 138, Sec. 2 of the Rules of Court of the Philippines]

n. Librarianship [RA 9246]

o. Marine deck officers [RA 8544]

p. Marine engine officers [RA 8544]
q. Master plumbing (RA 1378)
r. Sugar technology (RA 5197)
s. Social work (RA 4373)
t. Teaching (RA 7836)
u. Agriculture (RA 8435)
v. Fisheries (RA 8550)
w. Guidance counseling (RA 9258)
x. Real estate service (RA 9646)
y. Respiratory therapy (RA 10024)
z. Psychology (RA 10029)

3. Retail trade enterprises with paid-up capital of less than US$2,500,000 (Sec. 5 of RA 8762)\textsuperscript{15}

4. Cooperatives (Ch. III, Art. 26 of RA 6938)

5. Private security agencies (Sec. 4 of RA 5487)

6. Small-scale mining (Sec. 3 of RA 7076)

7. Utilization of marine resources in archipelagic waters, territorial sea, and exclusive economic zone as well as small-scale utilization of natural resources in rivers, lakes, bays, and lagoons (Art. XII, Sec. 2 of the Constitution)

8. Ownership, operation and management of cock-pits (Sec. 5 of PD 449)

9. Manufacture, repair, stockpiling, and/or distribution of nuclear weapons (Art II, Sec. 8 of the Constitution)\textsuperscript{16}

10. Manufacture, repair, stockpiling and/or distribution of biological, chemical and radiological weapons and anti-personnel mines (various treaties to which the Philippines is a signatory and conventions supported by the Philippines)\textsuperscript{3}

11. Manufacture of firecrackers and other pyrotechnic devices (Sec. 5 of RA 7183)

\textsuperscript{15} Full foreign participation is allowed for retail trade enterprises; (a) with paid-up capital of US$2,500,000 or more provided that investments for establishing a store is not less than US$830,000. or (b) specializing in high and or luxury products, provided that the paid-up capital per store is not less than US$250,000 (Sec. 5 of RA 8762)

\textsuperscript{16} Domestic investments are also prohibited (Art. II, Sec. 8 of the Constitution, Conventions/Treaties to which the Philippines is a signatory)
Up to Twenty Percent (20%) Foreign Equity
12. Private radio communications network (RA 3846)

Up to Twenty-Five Percent (25%) Foreign Equity
13. Private recruitment, whether for local or overseas employment (Art 27 of PD 442)
14. Contracts for the construction and repair of locally-funded public works (Sec. 1 of Commonwealth Act No. 541, Letter of Instruction No. 630) except:
   a. Infrastructure/development projects covered in RA 7718; and
   b. Projects which are foreign funded or assisted and required to undergo international competitive bidding (Sec. 2(a) of RA 7718)
15. Contracts for the construction of defense-related structures (Sec. 1 of CA 541)

Up to Thirty Percent (30%) Foreign Equity
16. Advertising (Art. XVI, Sec. 11 of the Constitution)

Up to Forty Percent (40%) Foreign Equity
17. Exploration, development and utilization of natural resources (Art. XII, Sec. 2 of the Constitution)\(^\text{17}\)
18. Ownership of private lands (Art. XII, Sec. 7 of the Constitution; Ch. 5. Sec. 22 of CA 141; Sec. 4 of RA 9182)
19. Operation and management of public utilities (Art. XII, Sec. 11 of the Constitution; Sec. 16 of CA 146)
20. Ownership/establishment and administration of educational institutions (Art. XIV, Sec. 4 of the Constitution)
21. Culture, production, milling, processing, trading except retailing, of rice and corn and acquiring, by barter, purchase or otherwise, rice and corn and the by-products thereof (Sec. 5 of PD 194)\(^\text{18}\)

\(^{17}\) Full foreign participation is allowed through financial or technical assistance agreement with the President (Art. XII, Sec. 2 of the Constitution)

\(^{18}\) Full foreign participation is allowed provided that within the 30-year period from start of operation, the foreign investor shall divest a minimum of 60 percent of their equity to Filipino citizens (Sec. 5 of PD 194; NFA Council Resolution No. 193s. 1998.)
22. Contracts for the supply of materials, goods and commodities to government-owned controlled corporation, company, agency or municipal corporation (Sec. 1 of RA 5183)

23. Project proponent and facility operator of a BOT Project requiring a public utilities franchise (Art. XII, Sec. 11 of the Constitution; Sec. 2 (a) of RA 7718)

24. Operation of deep sea commercial fishing vessels (Sec. 27 of RA 8550)

25. Adjustment companies (Sec. 323 of PD 612 as amended by PD 1814)

26. Ownership of condominium units where the common areas in the condominium project are co-owned by the owners of the separate units or owned by a corporation (Sec. 5 of RA 4726)

**Up to Forty-Nine Percent (49%) Foreign Equity**

27. Lending companies (Sec. 6 of RA 9474)\(^{19}\)

**Up to Sixty Percent (60%) Foreign Equity**

28. Financing companies regulated by the SEC (Sec. 6 of RA 5980 as amended by RA 8556)\(^6\)

29. Investment houses regulated by the SEC (Sec. 5 of PD 129 as amended by RA 8366)\(^6\)

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\(^{19}\) No foreign national may be allowed to own stock in lending companies, financing companies or investment houses unless the country of which he is a national accords the same reciprocal rights to Filipinos (Sec. 6 of RA 9474; Sec. 6 of RA 5980 as amended by RA 8556; PD 129 as amended by RA 8366)
LIST B: FOREIGN OWNERSHIP IS LIMITED FOR REASONS OF SECURITY, DEFENSE, RISK TO HEALTH AND MORALS AND PROTECTION OF SMALL-AND MEDIUM-SCALE ENTERPRISES

“List B: Foreign Ownership is Limited for Reasons of Security, Defense Risk to Health and Morals and Protection of Small and Medium Scale Enterprise”

Up to Forty Percent (40%) Foreign Equity

1. Manufacture, repair, storage, and/or distribution of products and/or ingredients requiring Philippine National Police (PNP) clearance:
   a. Firearms (handguns to shotguns), parts of firearms and ammunition therefore, instruments or implements used or intended to be used in the manufacture of firearms
   b. Gunpowder
   c. Dynamite
   d. Blasting supplies
   e. Ingredients used in making explosive:
      i. Chlorates of potassium and sodium
      ii. Nitrates of ammonium, potassium, sodium barium, copper (11), lead (11), calcium and cuprite
      iii. Nitric acid
      iv. Nitrocellulose
      v. Perchlorates of ammonium, potassium and sodium
      vi. Dinitrocellulose
      vii. Glycerol
      viii. Amorphous phosphorus
      ix. Hydrogen peroxide
      x. Strontium nitrate powder
      xi. Toluene
f. Telescopic sights, sniper scope and other similar devices

However, the manufacture or repair of these items may be authorized by the Chief of the PNP to non-Philippine nationals; Provided that a substantial percentage of output, as determined by the said agency, is exported. Provided further that the extent of foreign equity ownership allowed shall be specified in the said authority/clearance (RA 7042 as amended by RA 8179).

2. Manufacture, repair, storage and/or distribution of products requiring Department of National Defense (DND) clearance:

   a. Guns and ammunition for warfare
   b. Military ordnance and parts thereof (e.g. torpedoes, depth charges, bombs, grenades, missiles)
   c. Gunnery, bombing and fire control systems and components
   d. Guided missiles/missile systems and components
   e. Tactical aircraft (fixed and rotary-winged), parts and components thereof
   f. Space vehicles and component systems
   g. Combat vessels (air, land and naval) and auxiliaries
   h. Weapons repair and maintenance equipment
   i. Military communications equipment
   j. Night vision equipment
   k. Stimulated coherent radiation devices, components and accessories
   l. Armament training devices
   m. Others as may be determined by the Secretary of the DND

However, the manufacture or repair of these items may be authorized by the Secretary of National Defense to non-Philippine nationals; Provided that a substantial percentage of output, as determined by the said agency, is exported. Provided further that the extent of foreign equity ownership allowed shall be specified in the said authority/clearance (RA 7042 as amended by RA 8179).

3. Manufacture and distribution of dangerous drugs (RA 7042 as amended by RA 8179)

4. Sauna and steam bathhouses, massage clinics and other like activities regulated by law because of risks posed to public health and morals (RA 7042 as amended by RA 8179)
5. All forms of gambling, except those covered by investment agreements with PAGCOR pursuant to RA 9487, or the PAGCOR Charter (RA 7042 as amended by RA 8179)

6. Domestic market enterprises with paid-in equity capital of less than the equivalent of US$200,000 (RA 7042 as amended by RA 8179)

7. Domestic market enterprises which involve advanced technology or employ at least fifty (50) direct employees with paid-in-equity capital of less than the equivalent of US$100,000 (RA 7042 as amended by RA 8179)
SINGAPORE
DISCLAIMER

It should be noted that the material in this book is designed to provide general information only. It is not offered as advice on any particular matter, whether it be legal, procedural or other, and should not be taken as such. The laws and regulations summarized in this book are current as of 16 November 2012. The authors expressly disclaim all liability to any person in respect of the consequences of anything done or omitted to be done wholly or partly in reliance upon the whole or any part of the contents of this book. No reader should act or refrain from acting on the basis of any matter contained in it without seeking specific professional advice on the particular facts and circumstances at issue.

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Mergers and acquisitions ("M&A") are carried out all over the world. Generally speaking, a merger consolidates two or more entities into a single economic unit whereas an acquisition is the outright purchase of either the assets or the shares of the target (i.e., the company whose shares or assets are to be acquired).

The motives for M&As are complex and varied because each transaction has its own unique economic terms and risk-sharing arrangements. Some common motives are listed below.

- A company may wish to expand by means of acquisition or merger rather than through continuous, natural growth, particularly if it wishes to enter into a new country or market where it previously had no presence and where it does not have the manpower or experience to start its own business from scratch.

- When two companies in the same industry are operating at a level below optimum, they may combine to achieve synergy and economies of scale. In addition, the combination of these two companies may lead to an increased market share, thus generating increased profitability. In some instances, the acquisition of a competitor reduces the economic threat to the acquirer.

- In times of recession, an acquisition or a merger may be used to restructure the companies involved so as to reduce workforce, output and/or other capacities. The redeployment of resources and the closing down of loss-making activities will help the companies survive in a falling market.
Guide to Mergers and Acquisitions

- Assets may be acquired at an undervalue from insolvent or financially troubled companies.

- A company can raise capital by making a share-for-share acquisition of a company that comprises largely cash and other liquid assets. Conversely, the shareholders of the target may take this opportunity to invest in a company that they consider has potential for growth.

- Some M&As are carried out not so much for any prospective economic advantage but because the management of a company wishes to assume ownership. Management buyouts have become quite popular in recent years.

- An acquisition may be induced by the tax and accounting opportunities available. The target may have valuable tax attributes that the acquirer wishes to obtain, such as carry forwards of operating losses, tax credits or capital allowances. In other cases, the acquirer may have loss or tax credit carry forwards that it wishes to offset against the target’s income after the acquisition.
Merger Process

The Companies Act was amended on 30 January 2006, to introduce new procedures for a form of legal merger of companies in Singapore. Before the amendments were introduced, commercial transactions commonly referred to as a merger were, in fact, asset acquisitions. For example, Company B would acquire the assets of Company A through an issue of its own shares to Company A as consideration. Alternatively, Company A and Company B might each inject all or part of their respective assets into Company C that would then issue its own shares to both Company A and Company B. While there was a consolidation of assets into one company, the legal identities of Company A, Company B and (where appropriate) Company C remained separate.

Pursuant to the aforesaid amendments, the Companies Act now allows a more efficient statutory form of merger and amalgamation. It provides for the amalgamation of two or more Singapore incorporated companies into a single entity that may be either one of the amalgamating companies or a new company.

There are certain requirements that must be complied with. In brief, these include the following:

- The terms of the amalgamation must be set out in an amalgamation proposal that must be approved by members of each amalgamating company by special resolution.
- The proposal must be sent to every secured creditor of the amalgamating company.
The directors of the amalgamating and amalgamated companies must make certain solvency statements in connection with the merger.

It is possible, however, to adopt an abbreviated or short-form amalgamation procedure in cases of internal group restructurings where one of the Singapore companies is wholly owned by the other, or if they are both wholly owned subsidiaries, directly or indirectly, of the same parent corporation (which can be non-Singaporean). Short-form amalgamations fall within one of two categories:

- An amalgamation pursuant to Section 215D(1) of the Companies Act between a Singapore incorporated parent company and its wholly owned subsidiary where the parent company will be the surviving entity
- An amalgamation pursuant to Section 215D(2) of the Act between two or more wholly owned Singapore incorporated companies of the same corporation where one of the subsidiaries will be the surviving entity

Diagrammatically, the two categories of amalgamation (as typically understood and undertaken) can be represented as follows:

**Section 215D(1) vertical amalgamation**
Section 215D(2) horizontal amalgamation

In the Section 215D(1) vertical amalgamation, the parent company will be the surviving entity whereas in the Section 215D(2) horizontal amalgamation, one of the subsidiaries will survive.

While these are the more common forms of amalgamations carried out in Singapore, Section 215D(2) however also potentially lends itself to a form of vertical amalgamation which can be diagrammatically represented as:

Section 215D(2) vertical amalgamation
The advantage of a Section 215D(2) vertical amalgamation over a Section 215D(1) vertical amalgamation is that for the latter, only the intermediate holding company can be the surviving entity post-amalgamation whereas a Section 215D(2) vertical amalgamation would permit the surviving entity to be either the intermediate holding company or the operating subsidiary. This may be useful if the contracts or licenses of the operating subsidiary contain provisions triggering certain rights or consent requirements in the event of a change in identity of the licensee or counterparty as would arise if the operating subsidiary is the non-surviving entity as a result of the amalgamation.

Note that despite the introduction of the statutory form of merger and amalgamation, the existing forms of asset transactions known as “mergers” will still continue to be relevant. One reason for this is that where the merger is between companies that are not in the same group, directors of the new amalgamated company may have certain reservations about making forward-looking solvency statements for the combined entity. Another reason is that the amalgamation regime also creates some uncertainties that have yet to be dealt with conclusively. In particular, there are still certain accounting concerns as to how the cancellation of shares in the amalgamating companies will be accounted for, particularly if the horizontal form of amalgamation is used. For this reason, in circumstances where a horizontal amalgamation might otherwise be feasible under the law, there have been instances where there is a preliminary share transfer where one of the Singapore entities becomes a subsidiary of the other to facilitate a vertical form of amalgamation under 215D(1).

Previously, the income tax and goods and services tax (“GST”) consequences in respect of corporate amalgamations were uncertain. However, with the enactment of a new tax framework for corporate amalgamations found in section 34C of the Income Tax Act, such uncertainties have largely been removed and corporate amalgamations have become more attractive for companies as the Inland Revenue Authority of Singapore has clarified that an amalgamation is a tax neutral event.

Share Transactions Versus Asset Transactions

When a business opportunity has been identified, the acquirer and the target can structure the acquisition in several ways. The acquirer may either purchase the shares in the target from its shareholders or purchase assets directly from the target. It may also consider a long-form amalgamation as a means to merge the target and its own acquisition vehicle but this remains an untested procedure for the reasons indicated above so the share and asset acquisition route remain the usual forms of acquisition on an arm’s length basis.
A share acquisition involves a transfer of ownership only of the shares in the target. However, an asset acquisition requires the passing of title to assets from the target to the acquirer. The target’s assets may include land and premises, stock and work in progress, book debts, intellectual property rights, goodwill, insurance, leasing, hire purchase and other contracts, employees, shares in other entities, plant and machinery. It will therefore be necessary to transfer each asset, or category of asset, from the target to the acquirer by way of different conveyances, assignments and transfers. This can be rather cumbersome. However, each acquisition is different and the following factors will help determine the most appropriate method in a particular case.

Partial Sale

A share acquisition may not be practical when only part of the target’s business is to be sold. Indeed, one of the main advantages of an asset acquisition is that the acquirer, can “cherry-pick” assets being purchased to avoid those assets that are not readily marketable and, or are of no use to the acquirer and avoid the associated liabilities.

Non-Transferable Assets

On the other hand, a share acquisition may be necessary if the target’s assets are not amenable to transfer, for example if the target has non-transferable government licenses or has entered into licensing or distribution arrangements that are not assignable.

Liabilities

A transfer of shares in the target also transfers all of the target’s assets and liabilities to the acquirer. As a legal person, the target has the capacity to incur contractual, tortious and criminal liabilities, some of which may not have been properly disclosed to the acquirer. Acquirers of assets, however, will not generally inherit the target’s liabilities. The acquirer need not acquire all the assets of the target and can avoid those assets with onerous liabilities.

Taxation

A share acquisition may be advantageous if the target has desirable tax attributes that the acquirer, through available exemptions, is able to utilize, such as carrying forward tax losses. An additional consideration is the potential difference in the amount of stamp duty payable between the two types of transactions.
Another factor to consider which may make share acquisitions more advantageous is the savings that may accrue to the parties if they qualify for the M&A scheme. Under the scheme, subject to conditions:

- an acquirer that acquires the ordinary shares of a target during the period 1 April 2010 to 31 March 2015 (both dates inclusive) is granted an M&A allowance, equal to 5% of up to SGD100 million of the acquisition value for all qualifying M&A transactions executed in the basis period for the relevant year of assessment;
- stamp duty relief of up to SGD200,000 per financial year is granted on an instrument of transfer or sale of ordinary shares under an M&A deal that is executed during the period 1 April 2010 to 31 March 2015 (both dates inclusive); and
- a 200% allowance of up to SGD100,000 in each year of assessment is granted on transactions costs (e.g., legal fees, accounting or tax advisor’s fees and valuation fees) incurred on qualifying M&As in the period 17 February 2012 to 31 March 2015 (both dates inclusive).

The conditions which need to be satisfied to qualify for the M&A scheme include the following:

- The acquiring company must be incorporated and tax resident in Singapore (“Singco”), or must be a wholly owned subsidiary of Singco.
- If Singco was a subsidiary of any other company, Singco’s ultimate holding company must be another Singapore company (although we note that this condition may be waived by the relevant government authority on a case-by-case basis if the company enjoys tax incentives in view of having its headquarters in Singapore).
- Generally, the target cannot be a related entity of Singco for the period two years prior to the acquisition (and which therefore rules out internal restructurings).

Share Acquisitions

The sale and purchase of shares in a target company is between an existing shareholder and a third-party potential shareholder. The sale and purchase will not involve the creditors of the target company unless there are pre-existing covenants with them requiring their approval for a change of control of the company.
Payment to the Sellers

In respect of the monies paid to the sellers, the buyer may require more than the traditional representations and warranties relating to the affairs and operations of the company. Suing on the representations, warranties and indemnities is always a long, expensive and cumbersome process, and the buyer can never be sure that, at a later date, the sellers will be in a position to repay the consideration received by them.

To offer more protection for buyers, the acquisition may be structured in various ways.

Staggering Payment to the Sellers - It would not be unreasonable to negotiate for staggered payments of the consideration. Thus, the acquisition may be completed but full payment (or any adjustments thereto) may be made over a period of time stretching over, for example, three, six or 12 months. This is to allow the buyer sufficient time to find out more about the company and to hold back the remaining payments in the event of any breaches of the representations and warranties. The buyer may then claim against the withheld amount as compensation for any such breaches.

Call Options - Financially pressed shareholders may agree to a deal whereby the buyer pays some money for a portion of the shares in the target, with a call option for the remaining shares. The initial stake will enable the buyer to take part in the management of the company, and find out more about its viability before deciding whether to commit further by exercising its call option on the remainder of the shares.

Management Earn-Outs - In a situation where the sellers are also the management of the target, it may be possible to negotiate a deal whereby the total consideration received by such sellers is stretched out over a period of, for example, two to three years, with payments being made on an annual basis and calculated using a formula that factors in the performance of the company over the agreed period of time. Of course, this may include a lump-sum payment upfront as a sweetener for the sellers.

Cash Injection Into Target

If the company is in financial trouble, the buyer may be able to acquire it for a relatively small consideration. However, it is likely that the buyer will be required to inject more money into the company to keep it afloat. One way to ensure that the buyer is able to get its money back is to extend the funds to the target company by way of a loan. Such a loan will almost certainly be required to be subordinated in order not to further aggravate the situation with the creditors.
The following structures may also be considered:

**Share Buybacks: Ordinary Shares/Non-Redeemable Preference Shares** - The Companies Act allows companies, subject to some restrictions, to repurchase their own ordinary shares, stocks and non-redeemable preference shares. Thus, the acquisition of shares may be a way for the company to return capital to investors. However, such acquisitions are subject to compliance with certain requirements. For example, they may not exceed 10% of the total number of issued ordinary shares or issued non-redeemable preference shares (as the case may be) of the company. Solvency statements are also required from the directors of the company if payment is to be made out of capital rather than profits.

**Redeemable Preference Shares** - Preference shares may be structured as redeemable preference shares. The advantage of such shares is that they may be structured so that the holder obtains a priority with respect to payment of dividends (these dividend entitlements can be cumulative) or repayment of capital in a winding up of the company. Such shares may also be structured with full voting rights.

The redemption feature further allows the amount paid-up on such shares to be repaid to the holders. It is now possible to use the share capital account to effect redemption under the Companies Act (see below).

Ordinary shares cannot normally be converted into redeemable preference shares. However, redeemable preference shares can be designed to be convertible into ordinary shares. Thus, the convertibility feature can be added to such shares, which adds to their attraction. The conversion may be made at the option of the holder when the holder’s comfort level with the economic state of the company has improved or prior to an initial public offering of the company’s shares.

**Share Buybacks and Redeemable Preference Shares: Source of Funds** - The Companies Act now allows share buybacks to be funded out of the share capital as well as distributable profits, provided the company is solvent. This is also applicable to the redemption of preference shares, as noted above.

**Share Buybacks: Treasury Shares** - The share buyback regime requires any repurchased shares to be either cancelled immediately upon acquisition or held as treasury shares. Upon cancellation of those shares, the rights and privileges attaching to them will expire. Allowing repurchased shares to be held as treasury shares extends the scope for Singapore companies to utilize share buybacks as a form of capital restructuring.
Convertible Bonds - Convertible bonds are debt instruments and documentation in relation to such bonds will contain many features that are commonly found in loan documentation. The holders of convertible bonds will be able to convert them into shares in the company either at their option or upon the occurrence of certain events, such as an initial public offering of the company’s shares. Where the bonds are not converted after a certain time or upon certain events, they may be redeemable at face value or at a premium. Convertible bonds typically bear interest.

Financial Assistance - Care must be taken to ensure that, in structuring the acquisition of shares, the provisions of the Companies Act that deal with restrictions against a target company financially assisting a buyer in the acquisition of the target company’s shares are not contravened.

The financial assistance restrictions have been relaxed, such that financial assistance may be provided in additional circumstances, such as:

- where the amount of the financial assistance does not exceed 10% of the aggregate of the total paid-up capital of the company and the reserves of the company; or
- where all the members of the company present and voting either in person or by proxy at a shareholders’ meeting have passed a resolution (or alternatively by unanimous written resolution) to give that assistance, and the financial assistance is given not more than 12 months after the resolution is passed.

In both situations, the board of directors must, among other items, pass resolutions concluding that the giving of assistance is in the best interests of the company, and that the terms of assistance are fair and reasonable to both the receiver and giver of assistance. A solvency statement will also be required.

Note that acquirers of companies that hold Singapore companies as part of their assets (whether or not the holding company is itself a Singapore entity) need to be aware that the financial assistance provisions will apply also to any assistance provided by the Singapore subsidiary to the acquisition of shares in its parent, unless an exemption applies.

Capital Reduction Process - The Companies Act provides two ways in which a Singapore company can reduce its share capital:

- Where the shareholders pass a special resolution approving such reduction, and where the court gives its approval (Court-sanctioned Capital Reduction)
Where the shareholders pass a special resolution approving such reduction, the directors provide a solvency statement and where certain publicity requirements are adhered to (Non-Court Sanctioned Capital Reduction)

In the case of a Court-Sanctioned Capital Reduction, the company would have to send to the Comptroller a notice of proposed reduction within eight days of the special resolution date and in any case, before making an application to the court.

The company will then attend a first hearing with the court usually to, among other things: fix a date for hearing of the originating summons; dispense with the requirements under the Companies Act with regard to creditors of the company; and seek direction as to the advertisement of the originating summons.

If the requirements under the Companies Act are not dispensed with, the company will need to settle the list of creditors and to file the same with the court. Thereafter, the company will file the notice of advertisement and affidavit proving service of the notice and advertisement. The court usually requires a newspaper advertisement at least eight days prior to the confirmation hearing.

The resolution and the reduction of capital shall not take effect until: the court order has been made, the company has lodged certain information with the Accounting and Corporate Regulatory Authority (“ACRA”) and ACRA has recorded the information in the appropriate register.

In the case of a Non-Court Sanctioned Capital Reduction, the company will need to file a notice of the special resolution with ACRA. The company will then need to prepare a solvency statement from the directors. This solvency statement must not have been made before the beginning of the period of 22 days (for public companies) and 15 days (for private companies) ending with the resolution date. A copy of a solvency statement from the directors in relation to the company, together with the copy of the resolution, need to be lodged with ACRA within 15 days beginning with the special resolution date.

The company needs to send a notice to the Comptroller.

Creditors of companies who wish to object to such Non-Court Sanctioned Capital Reduction will be allowed to do so within six weeks of the date of the special resolution. If no application for cancellation of the resolution has been made during this six-week period, the reduction of share capital will take effect after the company lodges with ACRA certain documents (including the solvency statement and a notice containing the reduction information) after the end of six weeks, and before the end of eight weeks beginning with the special resolution date.
Proposed Changes to the Companies Act – In 2011, the Ministry of Finance, together with ACRA, released a report proposing changes to the Companies Act. The report was prepared by the Steering Committee established by the Ministry of Finance. On 3 October 2012, the Ministry of Finance issued a response in respect of the report and has agreed to accept most of the recommendations of the Steering Committee. The amendments, which seek to ensure an efficient and transparent corporate regulatory framework, will likely be implemented at the end of 2013. These amendments include:

- adopting one uniform solvency test for redemption of preference shares, share buy backs, financial assistance and capital reduction processes (i.e., a statement by directors which states that based on the company’s current situation, there are no grounds on which it is unable to pay its debts at the point of the transaction and within a 12-month forward looking period). Furthermore, a declaration from the directors will suffice and it is no longer a requirement for the directors to provide statutory declarations which must follow a particular form and signed in the presence of a Commissioner for Oaths;

- removing the prohibitions on financial assistance for private companies but will continue to apply to public companies and their subsidiaries;

- clarifying that short-form amalgamations will be allowed between a holding company and its wholly-owned subsidiary whereby the subsidiary is the surviving amalgamating company, and that the amalgamation provisions will not be extended to foreign companies.

Asset Acquisitions

Some investors may prefer to purchase specific assets in a target company as opposed to shares in the target. The purchase of assets enables them to avoid the liabilities of the company and to “cherry-pick” only the viable parts of the business. Where only assets are purchased, the sale and purchase agreement may not have as extensive a set of representations and warranties as are usually found in share purchase agreements. To the extent that representations and warranties are required and given, they will usually only cover the condition of, title to, and ownership of, the assets. However, the sale and purchase agreement should be detailed as to exactly what assets are being purchased to avoid any future disputes with the target, other buyers, creditors or liquidators.
Winding Up

Where the seller is in danger of being wound up, this would have an impact on the validity of the transfer of the assets.

The process of winding up is deemed to have commenced at the time the winding up petition is presented. It will take some time before the petition is heard by the courts and the seller may continue business until the hearing. If the court decides to grant the petition, an order for the winding up of the company will be made, and a liquidator appointed to wind up the company’s business, realize its assets, pay off creditors and return the remainder of the assets to the shareholders. Transactions with the company during this process may be divided into three categories.

Deals Closed Before the Winding up is Commenced

A contract made by a company to buy and sell its assets before winding up is commenced will usually be valid. It will only be void if it is a deal aimed at avoiding the effects of liquidation.

The Companies Act essentially applies the anti-avoidance provisions of the Bankruptcy Act to companies. Therefore, a contract made with a company before winding up is commenced will be void or voidable if, under the Bankruptcy Act, it would have been void or voidable had it been made with an individual.

Accordingly, a pre-winding up transaction can be set aside if:

• the company entered into that transaction at an undervalue or gave an unfair preference to a creditor of the company;

• the transaction was entered into within a certain time (where the transaction is with an associate, within two years and in any other case, within six months) before the commencement of the winding-up proceedings; and

• the company was insolvent at the time or became insolvent as a consequence of the transaction or preference.

If these requirements are fulfilled, the court may make an order as it sees fit to restore the company to its pre-transaction position.
Transactions Made in the Interim Period Between the Presentation of a Winding-Up Petition and the Order for Winding Up

The Companies Act states that any disposition of company property after the commencement of winding up is void, unless otherwise ordered by the court. It should also be noted that when a court grants a petition for winding up, the order acts retrospectively, beginning on the date that the petition is presented. This means that all deals made in the interim period will be invalid unless the court validates them. Any person who acquires any part of a company’s property after the presentation of the petition for winding up therefore runs the risk that he or she will have to return the property to the liquidators. Thus, it is advisable to stop dealing with a troubled company once a petition for winding up has been presented.

The exercise of the court’s discretion in validating a disposition of property under this provision has been discussed in a number of cases. It has been frequently held that the free assets of an insolvent company should be distributed among the unsecured creditors.

The court will generally only validate a post-petition disposition where it would be beneficial not only for the company but also for the unsecured creditors, for example, where the company had to act speedily to dispose of certain property at an exceptionally good price. Alternatively, it may be desirable that the company is able to continue as a going concern as opposed to its assets being broken up. Admittedly, this latter case involves a certain amount of speculation that the courts must weigh up against the consideration that the needs of the creditors must not be prejudiced. The burden of proving that the deal was beneficial to the troubled company lies with the party seeking the order.

There are situations in which obligations exist prior to the commencement of winding up but where a contract is completed only after the presentation of the petition. It is not a disposition of property to complete a contract after the commencement of winding up if the contract had become specifically enforceable before the commencement. In the case of a sale and purchase of a troubled company’s assets that is subject to conditions, if the conditions have been met prior to the commencement of winding up, the contract would be specifically enforceable and thus may be completed, even after the winding-up petition is presented. This is subject to the above comments on how pre-petition transactions may be set aside.
Deals Entered Into After the Order for Winding Up is Made Against the Troubled Company

In such a situation, any purported deal with the company will be void unless made with the appointed liquidator on behalf of the company, who takes custody or control of all the property or rights to which the company is entitled. The liquidator has the power to carry on the business of the company but only so far as is necessary for the winding up of the company. The liquidator has the right to sell the property of the company as he or she deems fit in order to realize the assets and satisfy the company’s debts.
Preliminary Agreement - Memorandum of Understanding/Letter of Intent

A memorandum of understanding ("MOU") or letter of intent is relatively common in Singapore, depending on the intentions of the parties. It is sometimes used to clearly spell out the key commercial terms and the responsibilities of the parties involved in the transaction. Further, MOUs containing exclusivity clauses may also serve to prevent the parties from negotiating with other third parties once an initial agreement has been struck.

Depending on the intention of the parties and the way it is drafted, an MOU or a letter of intent can be a binding contract between the parties involved. However, an agreement to agree is not enforceable under Singapore law. If the intention of the parties is not to be bound by the MOU or the letter of intent, care must be taken when drafting the document.

Due Diligence

Due diligence is common during acquisition exercises. Buyers are generally encouraged to conduct proper due diligence on the assets or shares they propose to purchase to avoid complications after the acquisition.

As for acquisitions or takeovers of shares in listed companies, due diligence is becoming increasingly important in Singapore. However, there are strict insider trading laws that restrict parties from providing material non-public price-
sensitive information to a potential buyer, and a potential buyer in possession of such information cannot trade in the market in the shares of the company in question.

A potential acquirer of shares in a company listed on the Singapore Exchange may seek comfort from the obligation that is placed upon the listed company to disclose corporate information relating to its business activities (see Public or Listed Company Considerations). The Singapore Exchange Securities Trading Limited (the “Exchange”) has stressed that its corporate disclosure policy forms part of the ongoing listing requirements for listing in Singapore. These include rules on:

- immediate public disclosure of material information;
- thorough public dissemination;
- clarification or confirmation of rumors and reports; and
- insider trading.

Documentation and Agreements

In Singapore, it is common for the buyer’s lawyers to prepare the first draft of the acquisition documentation and agreements. The parties will then work and negotiate on the first draft documentation and agreements.

In a takeover offer transaction, both the offeror/buyer and the target company are obliged to prepare the necessary statutory and other relevant documents to inform, amongst others, the authorities and the shareholders of the offer.

Representations and Warranties

Representations and warranties are commonly found in all acquisition agreements. It is unusual for the buyer to give significant warranties, particularly if the purchase price is in cash. However, assurances that the purchase has been properly authorized according to the buyer’s internal rules are commonly sought by the seller. The seller should also warrant that it has the authority to sell its assets or shares to the buyer.

Further, the seller is likely to warrant the condition of the business in considerable detail. Warranties will include the financial position of the business, its commitments and contingencies, records and returns, its title, insurance and compliance with laws.
Checklist for Provisions in an Acquisition Agreement

Checklists will vary on a case-by-case basis and a tailor-made checklist should be prepared for different transactions.

Completion

Completion of a transaction is generally coupled with the parties satisfying the conditions specified in the agreements. If the necessary approvals are not obtained in the specified time period, the parties may either waive the condition(s) or terminate the transaction.
In Singapore, there are currently no exchange controls in place. In share or asset acquisitions, certain consents and approvals are required before the transaction can be completed. Some common examples are given below.

- The Companies Act provides that if the target is disposing of the whole or substantially the whole of its undertaking or property, the approval of the shareholders at a general meeting must be obtained.

- In an acquisition of some but not all of the shares of a company, the consent of the other shareholders may be required to waive their pre-emption rights under the Articles of Association of the target, if any. In an acquisition of assets, the target’s Articles of Association must also be checked to see whether the disposal of all or any of its assets requires consent from all or some of its shareholders. The same consideration applies to any shareholders’ agreement entered into by the shareholders of the target, which may have provisions restricting the disposal of shares or assets in the target.

- Contractual consents may be required from third parties such as creditors, landlords, debenture holders, mortgagees and other contracting parties to the transfer of assets (in the case of an asset acquisition) or the change of control (in the case of a share acquisition).
Industry consents from the relevant industry regulator may also be necessary, depending on the nature of the target’s business. This is often common in industries such as banking, insurance and telecommunications. In some industries, however, a change of control or transfer of assets may merely require notification to the relevant authorities rather than an obligation to obtain consent.

Merger control approval from the anti-trust/competition regulator may be necessary, depending on whether the proposed transaction would substantially lessen competition in a market in Singapore (see Competition and Anti-trust).

The approval of the shareholders of the buyer may be required when the allotment and issue of shares in the buyer is part or all of the purchase price for the acquisition of shares or assets in the target.

In the context of M&As, if the transaction proceeds by way of an amalgamation or if shares are transferred or new shares are issued in the target or buyer (if Singaporean), as part of a share or asset purchase, then certain filings will be required at ACRA.
Merger Provisions Under Singapore’s Competition Act (Cap.50B)

The Competition Act seeks to prohibit various forms of anti-competitive activities within Singapore. The three prohibited activities under the Competition Act are:

- anti-competitive agreements, decisions and practices whose object or effect is the prevention, restriction or distortion of competition within Singapore (Section 34 Prohibition);
- abuse of a dominant position in any market in Singapore (Section 47 Prohibition); and
- M&As that substantially lessen competition in any market in Singapore (Section 54 Prohibition).

Since its enactment in 2004, the Competition Act has been implemented in phases. The competition regulator, the Competition Commission of Singapore ("CCS"), was set up in 2005 and the Section 34 and 47 Prohibitions came into force in 2006. On 1 July 2007, the Section 54 Prohibition relating to M&As and certain joint ventures came into effect.

The provisions in the Competition Act are drafted broadly and, as such, the CCS has published several guidelines that provide details on how the CCS will, or is likely to, interpret and implement various aspects of the Competition Act, including the three prohibitions mentioned above. The guidelines may be obtained from CCS’s website (www.ccs.gov.sg) under the section CCS Guidelines. The
guidelines are meant to provide insight into CCS’s evaluative philosophy, but they are neither binding on the CCS nor a substitute for the Competition Act, and are subject to revision from time-to-time.

The following guidelines are specific to the Section 54 Prohibition:

- Guidelines on the substantive assessment of mergers
- Guidelines on merger procedures

We should highlight that the Guidelines on merger procedures have been recently revised, with the revised guidelines coming into effect on 1 July 2012. Other useful guidelines which are also applicable to the other two prohibitions include the following:

- Guidelines on major provisions
- Guidelines on market definition
- Guidelines on powers of investigation
- Guidelines on enforcement

In addition to the guidelines, CCS’s website contains explanatory notes on topics such as pre-notification discussions, merger notifications and calculation of notification fees.

Competition law in Singapore has in recent years built up some local jurisprudence. At the time of writing, there have been 32 mergers notified to the CCS, all of which have been cleared by the CCS except for two applications which are pending and two which have been withdrawn. In two of the 28 applications cleared, it is noted that the CCS had taken into account commitments that had been offered to overseas competition authorities which would sufficiently address competition concerns arising in Singapore.

Where further elaboration of the Competition Act beyond that stated in the guidelines is required, it is likely that EU and UK case law will be looked to for assistance since many provisions of the Competition Act, including some aspects of Section 54, are based on EU and UK legislation.

Section 54 Prohibition

Section 54 of the Competition Act prohibits mergers that substantially lessen competition in any market in Singapore without any off-setting efficiency benefits. It applies to mergers that have been completed and to anticipated mergers.
The Competition Act is triggered when, generally speaking, competition is affected in the Singapore market. As such, so long as the merger or anticipated merger substantially lessens competition in any market in Singapore, Section 54 of the Competition Act will be engaged even if the merger takes place outside of Singapore or where any party involved is outside of Singapore. Conversely, Section 54 of the Competition Act will not be engaged if a merger between two Singaporean companies substantially lessens competition in a foreign market but does not do so in the relevant market in Singapore. The merger in that case may then need to be examined in light of the merger provisions of the foreign jurisdiction that it affects.

The Section 54 Prohibition is drafted widely to cover M&As in its many forms, including amalgamations and controlling share or asset acquisitions. It also applies to joint ventures that perform, on a lasting basis, all functions of an autonomous economic entity. Such joint ventures will be found as constituting a merger under the Competition Act.

In determining whether control has been acquired over a target undertaking, the CCS will assess whether decisive influence over the target undertaking is capable of being exercised by the acquirer. Control may be obtained directly or indirectly or through contractual arrangements.

Each merger will be assessed by the CCS on a case-by-case basis. However, the CCS has set certain thresholds which it feels are typically reflective of decisive influence being acquired. These thresholds correspond to the thresholds for mandatory offers prescribed in Singapore’s Code on Takeovers and Mergers. The CCS thresholds are as follows:

- Generally, the CCS will deem decisive influence to exist if ownership of more than 50% of the voting rights of the target undertaking is acquired.
- Where ownership of 30%-50% of the voting rights of the target undertaking is acquired, the CCS will presume that decisive influence exists, but this presumption is rebuttable.

Notwithstanding the above thresholds, the CCS will review each case having regard to all relevant facts and circumstances. For instance, an acquisition of a majority stake may not result in control being obtained by the majority shareholder if there exists provisions in a shareholders’ agreement giving the minority shareholders powerful veto rights or joint control, or where the majority shareholder’s interest is not in operating the undertaking and, therefore, its approval is not needed for important commercial decisions.
Exclusions and Exemptions

There are various exclusions and exceptions to the Section 54 Prohibition. Broadly, the following mergers will not be subject to the Section 54 Prohibitions:

- Mergers approved or under the jurisdiction of any regulatory authority other than the CCS (examples include the banking, telecommunications, media and energy sectors)
- Mergers of undertakings carrying out “specified activities,” namely, postal services, the supply of piped potable water, the supply of wastewater management, bus and rail services, and cargo terminal operations
- Mergers with economic efficiencies outweighing adverse effects caused by substantial lessening of competition in the relevant market in Singapore

In addition to these exclusions, the Competition Act sets out four situations where the acquisition of a controlling interest will not constitute a merger:

- Control is acquired by a receiver, liquidator or underwriter.
- Internal restructuring where the undertakings involved are under control (direct or indirect) of the same undertaking, such that the first mentioned undertakings, have no economic independence.
- Control results from a testamentary disposition or intestacy or right of survivorship in a joint tenancy.
- Acquisitions by parties whose normal activities include the carrying out of transactions and dealings in securities for their own account or the account of others; in this case, the holding of the securities must be on a temporary basis.

De Minimis Thresholds

The CCS is generally of the view that competition concerns are unlikely to arise unless:

- the merged undertakings will have a market share of 40% or more; or
- the merged undertakings will have a market share of 20% - 40% and the post-merger combined market share of the three largest companies in the market is 70% or more.
In the revised merger guidelines, the CCS has also indicated that it is unlikely to investigate a merger situation that only involves small companies, namely, where the turnover in Singapore in the financial year preceding the transaction of each of the parties is below SGD5 million and the combined worldwide turnover in the financial year preceding the transaction of all of the parties is below SGD50 million. The turnover in Singapore refers to the turnover booked in Singapore as well as turnover from customers in Singapore.

However, these thresholds are simply indicators of when the CCS considers potential competition concerns may arise. They do not give rise to a presumption that such a merger will substantially lessen competition, a case-by-case analysis will still be required. Nevertheless, the indicators above may be used for self-assessment in deciding whether to file a notification to the CCS.

**Substantial Lessening of Competition**

Should the indicators mentioned above be met and the merger in question is unable to benefit from the exclusions and exemptions mentioned in the Competition Act, it will then need to be considered whether the merger will substantially lessen competition within any market in Singapore.

Establishing the relevant market is very important and is often a complex exercise involving economic analysis and industry expertise. Economic and industry experts should be appointed for this.

The relevant market has at least two dimensions: product and geography. The CCS Guidelines on Market Definition explain the methodology adopted by the CCS in defining the relevant market for the Section 34 and 47 Prohibitions, i.e., the “hypothetical monopolist test” or “SSNIP test.” Very broadly, this test involves identifying the product under investigation (“focal product”), all the products that buyers would regard as substitutes for the focal product; all suppliers of the focal product and its substitutes; and determining if a hypothetical monopolist controlling such a market can act without constraint. Much of this test is applicable to the Section 54 Prohibition except that the relevant price level used in the merger analysis will be the current price rather than competitive price.

In assessing whether the merger will substantially lessen competition in the relevant market in Singapore, the CCS will examine factors such as:

- the characteristics of pre- and post-merger competition in the relevant market;
- changes in the market structure and concentration;
• the competitive situation without the merger (known also as counterfactual);
• coordinated and non-coordinated effects of the merged undertaking;
• barriers to entry and expansion into the market;
• existence of countervailing power;
• possible foreclosure of the market, especially for vertical mergers; and
• possibility of “portfolio power” such as tying, bundling and predatory behavior, especially for conglomerate mergers.

The CCS will also assess if there are any economic efficiencies that will outweigh the negative effects on competition. The CCS will consider whether there any applicable defenses to the merger such as the “failing firm” defense where parties must show that: without the merger, the undertaking will exit the market in the near future; the undertaking will be unable to reorganize its operations; and there is no lesser anti-competitive alternative to the merger.

**Filing Procedures**

In Singapore, it is not mandatory to notify a merger or anticipated merger. However, if on self-assessment (which the CCS encourages) the merger parties believe that the merger may trigger the Section 54 Prohibition, they may file a notification to the CCS.

*Confidential advice from the CCS*

Under the revised merger guidelines, the CCS has provided the possibility of obtaining confidential advice in respect of whether a merger is likely to raise competition concerns in Singapore. In order to obtain confidential advice from the CCS for a merger, certain conditions must be met:

(a) The merger must not be completed and there must be good faith between the parties to proceed with the transaction.

(b) The merger must not be in the public domain. The CCS may consider giving confidential advice in respect of mergers which are no longer confidential, but the parties are required to justify why they wish to receive confidential advice as opposed to filing a notification.

(c) The merger must raise a genuine issue in relation to the competitive assessment in Singapore (i.e., there must be some doubt as to whether the merger situation raises concerns such that notification is appropriate).
The information required to be provided to the CCS in order to obtain confidential advice is similar to that as required in the Form M1 (i.e., information similar to that as required for notification applications). Confidential advice is, however, not binding on the CCS since the CCS retains the right to investigate all merger situations as long as the relevant statutory requirements are met.

**Pre-notification discussions**

Parties may (but are not obliged to) make an application for pre-notification discussions ("PND") before submitting a notification to the CCS. A PND is useful as it provides the merger parties and the CCS an opportunity to discuss the merger as well as filing requirements under less formal procedures, and early familiarity with the merger may expedite the filing and review process when a notification is made. In addition, parties may obtain an early indication from the CCS if there are competition concerns, although it should be noted that CCS indications are not binding and the CCS will not indicate whether the merger in question will be permitted. Lastly, mergers discussed at a PND-level are not made public. If an application is made for a PND, the merger parties should submit a draft notification prior to meeting with the CCS for a PND. The PND process is in addition to the confidential advice route mentioned above.

**Submission of application for notification**

For the submission of a formal notification, Form M1 is submitted for a preliminary assessment and, if a detailed assessment is required, the CCS will notify the parties that they will have to submit Form M2. The CCS would typically take 30 working days from the acceptance of a completed Form M1 to issue the results of its assessment. Where Form M2 is required, the CCS will take about 120 working days from acceptance of a completed Form M2 to issue its results. Joint applications are encouraged for a speedier resolution. Confidential information from each party may, however, be submitted separately.

Notifications should only be made of mergers or anticipated mergers that parties are prepared to make publicly known. This is because Part 5 of Form M1 will be published on CCS's website for third-party views. Part 5 of Form M1 will contain the names of the applicant, a brief description of the merger (or anticipated merger as the case may be), reasons why the applicants believe that Section 54 of the Competition Act has not been infringed and a description of the goods and services involved.
The fees payable for a notification are dependent on whether or not the acquirer is a small or medium enterprise (“SME”) and the turnover of the undertaking or assets acquired. Generally, fees for a notification on mergers involving SMEs will be SGD5,000. In any other case where the turnover of the target or acquired asset is:

- less than SGD200 million, the fees will be SGD15,000;
- between SGD200 million and SGD600 million, the fees will be SGD50,000; or
- more than SGD600 million, the fees will be SGD100,000.

The CCS will consider undertakings in the manufacturing sector with a fixed asset investment of less than SGD15 million and undertakings in a non-manufacturing sector with less than 200 employees as SMEs.

Results of a Notification

If CCS decides that the merger or anticipated merger will not infringe Section 54 of the Competition Act, no further action will be taken by the CCS. CCS’s decision can however be revoked if: the information supplied is materially incomplete, false or misleading; any commitment made by the merger parties to the CCS is not adhered to; or the merger, when effected, materially differs from anticipated merger. Should the CCS decide to revoke its decision, it will have to notify the parties of its intended decision before the revocation.

If the CCS decides that the merger or anticipated merger will infringe Section 54 of the Competition Act, the CCS will state its reason for the decision. CCS’s preference is to permit the merger to continue if appropriate remedies can be put in place to restore competition in the relevant market in Singapore. If no remedies are possible and the merger has already been completed, the CCS can order the merger to be unwound.

Remedies may be structural or behavioral. Structural remedies include the divestment of the business units that lead to the competition concern (the CCS will have to approve the buyer) and revision or termination of the relevant contract with competition concerns. Behavioral remedies include giving commitments (e.g., non-solicitation of customers) and providing performance bonds and, or guarantees to secure compliance.

If the CCS determines that an infringement has been committed intentionally or negligently, it may levy a financial penalty on the infringing parties. The financial penalty may not exceed 10% of the turnover in Singapore of the infringing party’s business for each year of infringement up to a maximum of three years.
The following are the main tax issues that are relevant in share or asset acquisitions.

**Jurisdictional Tax**

**Income Tax**

In Singapore, profits derived by the transferor from the disposal of trading stock would be taxable at the normal corporate income tax rate, which is currently at 17%.

When trading stock is sold upon the discontinuance of a trade or business, the value of the trading stock sold is prescribed by the Income Tax Act, which provides that the value shall be equal to the purchase price, where the transferee intends to carry on a trade or business in Singapore and where the stock would be deductible as an expense in the transferee’s business. Otherwise, the transfer and all associated tax consequences are deemed to occur at market value.

The transfer of depreciable capital assets generally does not incur income tax, unless capital allowances have been granted and the disposal value exceeds the written-down value. This situation will result in a balancing charge meaning that the transferor becomes subject to corporate income tax. There is, however, provision in the Income Tax Act for the transfer of such assets on a rollover basis between related parties. The acquisition does not lead to the accrual of a corporate income tax liability for the target company.
Transactional Tax

Stamp Duty

In a share acquisition, the buyer generally pays stamp duty at approximately 0.2% of the purchase price paid for the shares or their market value, whichever is higher, unless relief for stamp duty is applicable. Market value is generally taken to be equivalent to the net asset value of the target’s shares. It is possible to allow for the cost to be borne by either or both of the parties by mutual agreement.

For target companies holding real estate on their balance sheet, amendments implemented by the Inland Revenue Authority of Singapore as a means of facilitating stamping now give transferees the option of using balance sheet values of properties to arrive at the net asset value.

Stamp duty is also payable on a conveyance, assignment or transfer of a real property asset that is effected by way of an instrument executed or received in Singapore. The rate of buyer’s stamp duty payable is 1% on the first SGD180,000 of the market value of or consideration for the relevant real property (whichever is higher); 2% on the next SGD180,000; and 3% thereafter. Stamp duty would generally be calculated at the relevant rates on the basis of the agreed sale price of the particular real property. However, the Stamp Duty Office could insist on payment of duty calculated based on a separate appraisal of fair market value if that is higher.

In addition to the buyer’s stamp duty, a seller’s stamp duty of 16%, 12%, 8% and 4%, respectively, is applicable for sellers who acquire residential properties on or after 14 January 2011, and dispose of them in the first, second, third and fourth year after acquisition.

With effect from 8 December 2011, an additional buyer’s stamp duty of 10% also applies to the purchase price or market value of the property (whichever is higher) when corporations purchase Singapore residential property.

In addition, when chargeable assets (immovable property or shares) of a company in liquidation are distributed in that form to its shareholders, it is now mandatory that such shareholders pay stamp duty based on the value of the assets (ad valorem) on the transfer.
Carrying Back/Forward Net Operating Losses and Capital Allowances

A one-year loss carry-back scheme is available, targeted at small businesses. From year of assessment 2011, this scheme provides for a carry back of current year unabsorbed capital allowances and tax losses to the immediately preceding year of assessment, capped at SGD100,000, subject to certain conditions.

A company is also generally entitled to carry forward business losses incurred in one year of assessment for deduction against its income in future years. However unabsorbed tax losses or capital allowances that a target company has at the time of acquisition may be lost or disregarded if the shareholding has altered substantially between the first day of the year of assessment in which the loss is claimed and the last day of the year in which it came into existence. There is provision for the Minister of Finance to waive the substantial shareholding requirement under the exemption described in Section 37(15) of the Income Tax Act and this will normally be the case where the acquisition has not been motivated primarily by the buyer’s wish to acquire the tax losses of the target.

Group Relief

With effect from year of assessment 2003, a group relief system is applicable, such that a company may transfer its current year unabsorbed capital allowances, current year unabsorbed trade losses and current year unabsorbed donations to another company in the same corporate group. To qualify for the relief, the transferor and the transferee company must both:

- be members of the same corporate group on the last day of the basis period;
- have the same accounting year-end; and
- comply with the administrative procedures for the application of group relief.

Two Singapore incorporated companies will be regarded as being in the same corporate group if one company beneficially owns at least 75% of the ordinary shares in the other company, or a third Singapore incorporated company beneficially owns at least 75% of the ordinary shares of each of the two companies.

Capital Gains Tax

Singapore does not impose any capital gains tax. However, regular trading in items such as shares and property may be subject to income tax.
Goods and Services Tax

Singapore also has a GST that is payable on the supply of goods and services in Singapore and should be taken into consideration in the case of an asset sale. However, most transfers of going concerns are excluded from GST provided certain conditions are met. GST does not apply to a sale of shares. Currently, GST is payable at the rate of 7%.
The Employment Act applies generally to persons who have entered into, or work under, a contract of service. It does not apply to any person employed in a managerial or executive position. Managers and executives are employees with executive or supervisory functions. These functions include the authority to influence or make decision on issues like recruitment, discipline, termination of employment, assessment of performance, or involvement in the formulation of strategies of the enterprise, or the management and running of the business. They also include professionals with tertiary education and specialized knowledge/skills and whose employment terms are comparable to those of managers and executives. Professionals such as lawyers, accountants, dentists and doctors whose nature and terms of employment are comparable to executives would generally be deemed as such, and hence they would not be covered under the Employment Act.

In cases where the Employment Act does not apply, terms and conditions of employment are largely left to be agreed between the employer and the employee. These conditions are usually written into a contract or letter of service that is signed by both the employer and the employee.

Other statutes dealing with aspects of employment include the Industrial Relations Act (containing provisions for a collective bargaining process where trade unions are involved), the Central Provident Fund Act, the Workplace Safety and Health Act and the Retirement and Re-employment Act. For areas not specifically governed by statute, common law applies.
The Employment Act contains general provisions on terms of employment including payment of salary, termination and period of notice of termination. There are certain other provisions covering areas such as working hours, rest days, annual leave and retirement benefits, which apply only to employees who earn SGD2,000 or less per month (or in the case of workmen, those who earn SGD4,500 or less per month). The Employment Act provides that any term in a contract of service to which the Employment Act applies that is less favorable to an employee than the corresponding condition of service prescribed by the Employment Act shall be illegal, null and void to the extent that it is less favorable. Otherwise, the employer and employee are free to negotiate the terms of employment.

Dismissal of any employee must be in accordance with the terms of his or her employment contract and where applicable, in accordance with the Employment Act or the common law. An employee is generally entitled to notice of termination. For employees who are employed in managerial or executive positions, in the absence of a provision in the contract of employment regarding notice, the employee would be entitled to reasonable notice under the common law. What is reasonable in respect of a particular employee will depend on a number of factors including age, seniority, length of service, functions and position in the company, and the salary payment period. Where employees fall within the ambit of the Employment Act and there is no provision in the employment contract dealing with notice, there are certain minimum statutory notice periods that must be observed by the employers. The Employment Act permits the payment of salary in lieu of notice. This may also be provided for under the employment contract.

There is no legislation in Singapore providing for payment of compulsory retrenchment benefits upon making an employee redundant. This is a matter usually dealt with in the employment contract. In the absence of contractual obligations to pay retrenchment benefits, it is market practice to pay ex gratia retrenchment benefits of between two and four weeks’ salary for each completed year of service.

In the context of an asset sale where the business is transferred on a going-concern basis, employees under the Employment Act will automatically transfer on their existing terms and conditions to the buyer. For non-Employment Act employees, their employment will first need to be terminated and then re-engaged with the buyer. For expatriate employees on employment passes, work passes or permits, a new pass or permit will be required in the name of their new employer.
Additional legal and regulatory issues arise where:

- the securities of the target company are listed on the Exchange;
- the target is a member of a Singapore listed group; or
- either the seller or the buyer is a Singapore listed company or is a member of a Singapore listed group.

**Insider trading**

Insider trading occurs where a person who is in possession of price-sensitive information regarding a company, that is not generally available to the public, deals in securities of that company. The main statutory provisions relating to insider trading are found in Part XII, Division 3 of the Securities and Futures Act. The Exchange’s Listing Manual also contains provisions regarding insider trading.

**Securities and Futures Act**

Under the Securities and Futures Act, a person may be found guilty of insider trading if he or she deals directly or indirectly in securities while in possession of non-public and price-sensitive information that he or she knows or ought reasonably to have known is non-public and price-sensitive. Information will be considered non-public and price-sensitive if it is not generally available and the nature of that information is such that if it were generally available, a reasonable
person would expect it to have a material effect on the price or value of the securities in question. In particular, it should be noted that persons connected to the corporation in question who have in their possession any information concerning that corporation that is not generally available will be presumed to know that such information is non-public and price-sensitive.

Under the Securities and Futures Act, there is no requirement for a person to have intended to use the insider information as it will be sufficient to establish that he or she knew or ought to have known that the information he possessed was non-public and price-sensitive.

Further, any person in possession of such information cannot communicate it, directly or indirectly, to another person if he or she knows or ought reasonably to have known that the latter would be likely to deal, directly or indirectly, in such securities. The recipient of such information will similarly be liable under the Securities and Futures Act if found to have engaged in insider trading. In other words, the offense is not limited to dealings by the corporate insider or persons to whom he or she directly passes such inside information but will also include other persons further down the information chain.

Section 201 of the Securities and Futures Act is a broad sweep-up clause designed to catch forms of securities fraud which somehow do not fall within the language of specific provisions or where the specific provisions fail for technical reasons. It forbids a person from:

- employing any device, scheme or artifice to defraud;
- engaging in any act, practice or course of business that operates or is likely to operate as a fraud or deceit upon any person;
- making any statement he or she knows to be false in a material particular; or
- omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

Listing Manual

The Listing Manual contains a statement of the Exchange’s policy on insider trading. While the Listing Manual makes reference to the requirement for a listed company to comply with any applicable legislation pertaining to insider trading, it also sets out its own list of persons who may be considered insiders and are prohibited from dealing in the listed company’s securities until after the relevant material information has been disclosed and fully disseminated to the public.
Companies listed on the Exchange are also advised to refer to Rule 1207(18) of the Listing Manual which provides guidance on the best practices with regard to dealings by the officers of the company in their respective companies’ securities.

Takeovers and mergers

In Singapore, takeovers of public companies are regulated by:

- The Securities and Futures Act, which is administered by the Monetary Authority of Singapore;
- The Singapore Code on Takeovers and Mergers (the “Code”), which is administered by the Securities Industry Council (the “Council”); and
- where the target is listed on the Exchange, the Listing Manual, which is administered by the Exchange.

The Code is issued pursuant to the Securities and Futures Act. While the Code does not have the force of law, parties in a takeover or merger transaction are required to comply with the letter and spirit of the Code. The Code is drafted with listed public companies and listed registered business trusts in mind but also applies to unlisted public companies and unlisted registered business trusts with more than 50 shareholders or unit holders, as the case may be, and SGD5 million or more of net tangible assets. The Code also applies to foreign incorporated companies and foreign registered business trusts with a primary listing on the Exchange, as well as real estate investment trusts (“REITs”) which are property trusts structured as collective investment schemes under the Securities and Futures Act.

The Council has the power to privately reprimand or publicly censure a company which does not comply with the provisions of the Code. In a flagrant case, the Council is empowered to take further action as it sees fit, including temporarily or permanently depriving the offender of its ability to enjoy the facilities of the securities market or requiring the offender to pay compensation to shareholders.

The main objectives of the Code are as follows:

- To establish fair dealing and equity between all the shareholders of a company that is the subject of a takeover bid. Thus, information given to any shareholder must also be given to other shareholders; the best premium that the offeror is willing to pay for control of the target company must be extended to all of the target company’s shareholders; and favorable deals made with any shareholder must be extended to all shareholders.
• To ensure that shareholders of the target company are given sufficient information in sufficient time to enable them to make a judgment on the merits of the offer.

• To ensure that any documents or advertisements addressed to shareholders containing any information or opinions from the offeror or the board of the target company are prepared to the highest standards of care and accuracy, as in the case of a prospectus (see further information below under Announcements, Information and Advertisements).

• To prevent the creation of a false market in the shares of an offeror or target company.

• To prevent directors of the target company from acting in their own interests or frustrating the offer before the shareholders of the target company have had an opportunity to consider it.

Mandatory Offers

Rule 14 of the Code provides that where an offeror (together with any party acting in concert with it) acquires 30% or more of the voting rights in a target company which is subject to the Code, it must make an offer to holders of any class of share capital that carries votes, and in which the offeror or persons acting in concert with it hold shares. Such an offer must be made at a price at least equal to the highest price paid by the offeror and its concert parties for shares of that class within the preceding six months.

Further, if any offeror (together with any party acting in concert with it), having 30% - 50% of the voting rights, acquires, in any period of six months, additional shares carrying more than 1% of the voting rights, that individual or group is deemed to have consolidated control, and accordingly, must make a mandatory offer in accordance with the Code. It should be noted that under the Code, the obligation to make a mandatory offer lies not only with the offeror but its concert parties as well.

Under the Code, any person who has acquired or written any option or derivative which causes him to have a long economic exposure to changes in the price of securities will normally be treated as having acquired those securities for the purposes of Rule 14 of the Code. Prior consultation with the Council is required if any person would breach the thresholds stipulated in Rule 14 as a result of acquiring such options or derivatives.
A mandatory offer must be made conditional upon the offeror receiving acceptances in respect of such numbers of shares which, together with the shares acquired or agreed to be acquired before or during the offer, will result in the offeror and its concert parties holding shares carrying more than 50% of the voting rights. Generally, there can be no other conditions attached, save in the specific situation where the mandatory offer falls within the ambit of the Competition Act (see further information under Offers Which Are Subject to the Merger Control Regime).

The Code requires that the offer be open for acceptance for at least 28 days after the posting of the offer document (see box General Timeframe for Takeover Offers). The minimum period is prescribed to ensure that the Target Company’s shareholders have sufficient time to decide on the terms of the offer. The offeror may extend the closing date but once an offer becomes unconditional as to acceptances (i.e., the “50 percent plus one share” mark is reached) the offeror must keep the offer open for acceptance for an additional 14 days, unless a shut-off notice has been issued. The objective of this requirement is to enable undecided shareholders to have a period within which to decide whether they wish to sell out or remain in the target company as minority shareholders.

In the event that the offeror revises his or her offer, either voluntarily or because of the Code, the revised offer must be kept open for at least 14 days from the date the revised offer document is posted to the target company’s shareholders.

Except with the consent of Council, no offer can remain open for more than 60 days after the day the offer is initially posted, unless it has previously become or been declared unconditional as to acceptances. As such, no offer should be revised after the 46th day from the posting of the original offer document.

Further, an offeror (and any of its concert parties) that has announced or posted an offer which was withdrawn or that lapsed without becoming unconditional, may not, within 12 months from the date of the withdrawal or lapsing, make another offer for the target company, unless prior consent from the Council had been obtained. The offeror and any parties working in concert with it are also prohibited from acquiring any shares in the target company within such 12-month period if they would thereby become subject to the mandatory offer obligation.

In certain cases of issuance of new securities or convertible instruments, where a mandatory offer would generally be triggered, the Code provides that the Council may grant a waiver from the obligation to make a mandatory offer if “whitewash” procedures are followed (including the approval of independent shareholders of the target company).
Voluntary Offers

A voluntary offer is a voluntary bid to acquire all the voting shares of the target company without having triggered any obligation to make a mandatory offer for such company.

A voluntary offer must be conditional upon the offeror receiving acceptances in respect of such numbers of shares which, together with the shares acquired or agreed to be acquired before or during the offer, will result in the offeror and its concert parties holding shares carrying more than 50% of the voting rights. Subject to certain conditions, the Council will also normally allow voluntary offers which are conditional upon a higher level of acceptances.

A voluntary offer may be subject to other conditions apart from the acceptance condition provided that the fulfillment of such conditions does not depend on the subjective interpretation or judgment by the offeror or lies in the hands of the offeror.

The procedures and timetable applicable to a voluntary offer are similar to those for a mandatory offer.

Partial Offers

A partial offer is a voluntary offer made by the offeror for less than 100% of a target company’s shares not already owned by the offeror and its concert parties. Partial offers are only allowed with the Council’s prior approval.

Offers for less than 30% - The Council will normally grant its consent to a partial offer which could result in the offeror and its concert parties carrying less than 30% of the voting rights of the target company.

Offers for between 30% and 50% - The Council will not consent to any partial offer which could result in the offeror and its concert parties holding 30% - 50% of the voting rights of the target company.

Offers for more than 50% - The Council will not normally grant its consent to a partial offer which could result in the offeror and its concert parties holding more than 50% of the voting rights of the target company, unless the following conditions are satisfied:

- The partial offer is not a mandatory offer under Rule 14 of the Code.
There is a moratorium on acquisitions of voting shares in the target company by the offeror and its concert parties beginning six months before the offer announcement is made and ending six months after the offer’s close (if the partial offer becomes unconditional). An exception is made for acquisitions of shares made under the partial offer itself, and rights and bonus issues (so long as the offeror’s aggregate percentage holding is not increased).

The offer must be made conditional on:

- the approval by more than 50% of the target company’s shareholders (excluding the offeror, its concert parties and their associates); and
- the stated number, proportion or percentage of acceptances being received. The offer may only be declared unconditional when the requisite level of acceptances is reached.

- the target company must make arrangements with the Exchange prior to the posting of the offer document to provide a temporary trading counter to trade odd-lots in the target company’s shares after the close of the partial offer for a reasonable period of time (in any case, not less than one month);
- the offer document must contain a specific and prominent statement to the effect that if the partial offer succeeds, the offeror will be able to exercise statutory control over the target company and that the offeror and its concert parties will be free, subject to the 12-month moratorium period as described above, to acquire further shares without incurring any obligation to make a general offer;
- the partial offer must be made to all shareholders of the class and arrangements must be made for those shareholders who wish to accept in full for the relevant percentage of their holdings. Shares tendered in excess of the percentage should be accepted by the offeror from each shareholder in the same proportion as the number tendered to the extent necessary to enable the offeror to obtain the total number of shares for which he or she has offered. The offeror should arrange its acceptance procedure to minimize the number of new odd-lot shareholdings;
- if there is more than one class of shareholders, a comparable offer must be made for each class;
- an appropriate partial offer must also be made to all holders of convertible securities, including shareholders by virtue of a conversion of convertible securities during the offer period; and
• the precise number, percentage or proportion of shares offered must be stated and the offer may not be declared unconditional as to acceptances until the requisite level of acceptances is reached.

An offeror who already holds more than 50% of the target company shares can make a partial offer without seeking the target company shareholders’ approval as long as the partial offer does not result in the target company breaching the minimum free float requirement under the Listing Manual.

Following a successful partial offer, the Council will normally approve an application by an offeror for share purchases in the target company during the 12-month period after the offer, provided six months or more have passed since the close of the partial offer. The Council would, however, not normally approve a subsequent partial offer by the same offeror within 12 months from the close of the previous partial offer (whether successful or not) unless the subsequent partial offer is recommended by the board of the target company and is proposed to be made by a person not acting in concert with the previous offeror.

**General Timeframe for Takeover Offers**

Below is a brief summary of the offer timetable after the dispatch of the offer document.

• From the date when the offer document is dispatched, an offer must initially be kept open for at least 28 days.

• If the offer is revised, it must be kept open for at least 14 days from the date on which the revision is posted to shareholders.

• After an offer has become unconditional, it must remain open for acceptance for at least 14 days after the date on which it would otherwise have expired, unless at least 14 days’ notice of such expiry was given by way of a “shut-off” notice. It should be noted that it is not possible to issue such a shut-off notice in a competitive situation.

• In general, no offer may be declared unconditional after 5.30 p.m. on the 60th day after the date the offer is initially posted. This 60-day time limit may be extended by the Council in a competitive situation.
Announcements, Information and Advertisements

During the course of the takeover, the offeror, the target company and their advisers will have to make certain announcements and statements concerning the offer. For instance, once an offeror has triggered a mandatory offer under Rule 14 of the Code, an immediate announcement is required by Rule 3.1 of the Code. An offer document should then be dispatched within 14 to 21 days of such an announcement.

The Rules and General Principles of the Code aim to ensure that information about a company involved in a takeover is made equally available to all shareholders as close as possible to the same time and in the same manner. The Code stipulates that any documents or advertisements issued to shareholders must be prepared with the highest standards of care and accuracy.

Care must be taken by the offeror, the target company and their advisers to ensure that no misleading announcements or statements are made. Indeed, the Code requires that the directors of the offeror and, or the target company, as the case may be, take personal responsibility. Any document or advertisement addressed to the shareholders of the target company and every announcement issued in connection with the offer, must include a directors’ responsibility statement indicating that they have taken all reasonable care to ensure that the facts stated and the opinions expressed are fair and accurate and that, where appropriate, no material facts have been omitted, and that they jointly and severally accept responsibility. The usual common law remedies for misrepresentation, negligence and breach of contract will apply.

Special care should also be taken by the target company and its advisers when issuing profit forecasts and asset valuations. There is no obligation to issue such forecasts and valuations but once they are published, the provisions of the Code must be complied with. This in essence requires that all profit forecasts must be supported by reports from auditors (or consultant accountants) and financial advisers, and that asset valuations must be made by independent valuers.

The Code also contains Rules and Guidance Notes regarding the conduct of press, television and radio interviews, meetings of shareholders, telephone campaigns and circulars by brokers aimed at ensuring that all shareholders have equal access to any information which may be distributed.
Trading Suspension

Generally, if an offeror has received acceptances that bring the holdings owned by it and any parties acting in concert with it to above 90% of the offeree company’s securities, the Exchange will invoke its power under the Listing Manual to suspend the listing of such securities in the Ready and Odd-Lots Markets. Such a suspension will remain in force until the Exchange is satisfied that there is an adequate spread of securities in public hands, that is, where at least 10% of the securities issued are held by at least 500 members of the public.

Privatization

Publicly listed companies in Singapore may be privatized or delisted by way of:

- a takeover offer followed by compulsory acquisition of all the remaining shares in the target company under Section 215 of the Companies Act (if the target company is incorporated in Singapore);
- a voluntary delisting under Rule 1307 of the Listing Manual, coupled with an exit offer to all the shareholders of the target company; or
- a scheme of arrangement under Section 210 of the Companies Act (if the target company is incorporated in Singapore).

For target companies which are listed on the Exchange but not incorporated in Singapore, the laws and regulations of the country of incorporation of the target company will generally determine if compulsory acquisition, schemes of arrangements or similar mechanisms are available to privatize or seek 100% control of the target company.

Compulsory Acquisition or Minority Squeeze-out

The Companies Act, in certain cases, allows an offeror to compulsorily acquire the shares of shareholders who have not accepted the offer if the offeror has received acceptances of at least 90% of the shares (not counting shares already held by the offeror, its nominees or related corporations on the date of the offer). The purpose of such a squeeze-out right is to stop minority shareholders holding 10% or less of the target company from preventing offerors that already have near total ownership of the shares from fully acquiring the other remaining shares (10% or less) and converting the acquired company into a wholly owned subsidiary.
If the 90% threshold is reached within four months of making the offer, the offeror may, by notice in the prescribed form, require the minority shareholders to sell their shares to it. These minority shareholders may apply to a Singapore court to stop the proposed acquisition if it is not genuine and in good faith.

Conversely, if a company acquires 90% of the remaining shares of another company not already owned by it, the minority shareholders in the target company may of their own accord serve notice on the acquiring company requiring the company to acquire their shares. The company is then obliged to acquire such shares from the minority shareholders.

**Voluntary Delisting**

A listed company may apply to be delisted from the Exchange if the following conditions are satisfied:

- The company convenes a general meeting to obtain shareholders approval for the delisting.
- The resolution to delist has been approved by a majority of at least 75% of the total number of issued shares held by the shareholders present and voting, on a poll, either in person or by proxy at the meeting (the company’s directors and controlling shareholder need not abstain from voting on the resolution).
- The resolution to delist has not been voted against by 10% or more of the total number of issued shares held by the shareholders present and voting, on a poll, either in person or by proxy at the meeting.

In addition, a reasonable exit alternative, which should normally be in cash, should be offered to the target company’s shareholders and holders of any other classes of listed securities to be delisted. The target company will normally be required to appoint an independent financial adviser to advise on the exit offer.

An exit offer made for the purposes of a voluntary delisting falls within the ambit of the Code and therefore needs to comply with the relevant rules of the Code unless otherwise waived by the Council. The exit offer will not be conditional upon a minimum number of acceptances being received by the offeror.
Scheme of Arrangement

Another way in which an offeror may acquire 100% of a publicly listed company in Singapore is via a scheme of arrangement of the target company pursuant to Section 210 of the Companies Act (“Scheme”). The following conditions must be satisfied before a Scheme will be effective:

- Separate meetings of different classes of shareholders who are affected by the Scheme have been held (the “scheme meeting(s)”).
- At each such scheme meeting, a majority in number representing at least 75% in value of the shareholders present and voting at such scheme meeting has approved the Scheme.
- The court has made an order approving the Scheme.

As the Scheme process is undertaken and generally controlled by the target company rather than the offeror, the full co-operation of the target company will be required for the success of a Scheme, so the mechanism is unlikely to be used in a hostile takeover situation.

The key steps which need to be taken to implement a Scheme are as follows:

- The offeror and the target company enter into a merger agreement.
- The target company applies to the Singapore court for permission to convene the scheme meeting(s).
- The target company convenes the scheme meeting(s) and dispatches an explanatory statement to the target company’s shareholders containing details of the Scheme.
- The target company holds the scheme meeting(s).
- The target company announces the result of the scheme meeting(s) and applies to the Singapore court for approval of the Scheme.
- The target company lodges a copy of order of court with ACRA. The Scheme does not take effect until a copy of the court order is so lodged.

Offers Which Are Subject to the Merger Control Regime

An offer which is subject to the Code may also fall within the ambit of the merger control provisions of the Competition Act. In such a case, the parties to the takeover offer will need to comply with the requirements under both the Code and the Competition Act. Guidance in this respect is provided by the Council in its Practice Statement issued on 29 May 2007.
To comply with both the Code and the Competition Act, an offeror may announce:

- a pre-conditional share purchase or put and call option agreement which, when the pre-conditions are fulfilled, will result in the offeror triggering a mandatory offer; or

- a pre-conditional voluntary offer, where one of the pre-conditions includes the condition that the CCS issues a favorable decision on the offer permitting it to proceed.

In the case where an offeror announces an offer without prior clearance by the CCS by way of a pre-conditional offer as described above, the offer (whether mandatory or voluntary) is required to be subject to the condition that the offer lapses when the CCS decides to undertake a Phase 2 review (i.e., a more in-depth review) of the transaction; or the CCS issues a direction prohibiting the offeror from acquiring voting rights in the offeree company, before the first closing date of the offer or the date when the offer becomes or is declared unconditional as to acceptances, whichever comes later (Relevant Condition).

Voluntary offers may also be made subject to the condition that the CCS issues a favorable decision during its Phase 1 (initial) review to allow the voluntary offer to proceed.

A mandatory offer must be reinstated if the CCS issues a favorable decision after the offer has lapsed due to the Relevant Condition. If an unfavorable decision is made by the CCS, the Council may require the offeror of a mandatory offer to reduce its level of control, for example, to below 30%, even if such a requirement has not been imposed by the CCS.

The 29 May 2007 Practice Statement issued by the Council provides further guidance with respect to the procedural interplay between the CCS approval procedure and the Code.

### Disclosure and shareholder approval requirements

#### Substantial Shareholding Disclosure Requirements

A substantial shareholder is one who is “interested” in 5% or more of the voting shares of any public company that is listed on the Exchange. Within two business days of becoming interested, a substantial shareholder must disclose in writing to the company and the Exchange the amount of his or her interests, the full particulars of such interest and the circumstances of that interest. Any subsequent increase or decrease in shareholding that causes a person’s
shareholding to cross a discrete percentage level must also be notified in writing to the company and the Exchange within two business days of the change. Persons who cease to be a substantial shareholder are similarly required to notify the company and the Exchange in writing within two business days of the cessation of interest. The Companies Act provides detailed guidance on when a person is deemed to be interested in the shares of a company for the purposes of substantial shareholding notifications.

The same disclosure requirements applicable to shareholders of listed companies as set out above also apply in the context of unit holders of REITs and business trusts.

**Disclosure Requirements under Listing Rules**

The Listing Manual obliges a listed company to disclose information that is necessary to avoid the establishment of a false market in its listed securities or which would be likely to have a material effect on the price or value of its securities. However, an exception from the requirement to make immediate disclosure of material information may be allowed where certain prescribed conditions in the Listing Manual are met.

This requirement to disclose is supplemented by the Exchange’s Corporate Disclosure Policy set out in Appendix 7.1 of the Listing Manual. Material information would include information known to the listed company concerning the company’s property, assets, business, financial condition and prospects; M&As; dealings with employees, suppliers and customers; material contracts or development projects (whether entered into in the ordinary course of business or otherwise); as well as information concerning a significant change in ownership of the company’s securities owned by insiders, or a change in effective or voting control of the company, and any developments that affect materially the present or potential rights or interests of the company’s shareholders. The Exchange has also provided in the Listing Manual a non-exhaustive list of situations which may or are likely to require immediate announcement by a listed company.

The Exchange maintains the policy so that the affairs of a listed company should be transparent, and listed companies have obligations to promptly account for and disclose material information. Material information should not generally be withheld or made known only to a small group of persons.

Apart from the general obligation to disclose material information, the Listing Manual also imposes specific disclosure obligations. For example, a listed company is required to announce immediately any change in its senior...
management, any notice of substantial shareholdings or changes thereto received by the company and any acquisition of shares in either a listed or unlisted company that exceeds a specified limit.

**Acquisitions and Divestments by Listed Companies**

An acquisition or disposal of assets by a listed company or its subsidiary (not listed on the Exchange or an approved exchange) which is not in the ordinary course of the company’s business or of a revenue nature may, depending on the size of the transaction, be subject to specific disclosure and approval requirements under the Listing Manual.

In order to determine whether an acquisition or disposal transaction is required to be immediately announced and/or required to be approved by shareholders, the following relative figures are computed:

- The net asset value of the assets to be disposed of, compared with the listed group’s net asset value (note that this basis is not applicable to an acquisition of assets)
- The net profits attributable to the assets acquired or disposed of, compared with the listed group’s net profits
- The aggregate value of the consideration given or received, compared with the listed company’s market capitalization
- The number of equity securities issued by the listed company as consideration for an acquisition, compared with the number of equity securities previously in issue (note that this basis is not applicable to a disposal of assets)

**Disclosable Transaction** - If any of the relative figures computed as above exceeds 5% but does not exceed 20%, then the transaction is regarded as a disclosable transaction and must be immediately announced. The information to be contained in such an announcement is prescribed in the Listing Manual.

**Major Transaction** - If any of the relative figures computed as above exceeds 20%, then the transaction is regarded as a major transaction. Such a transaction must not only be immediately announced, it must also be made conditional upon the approval of the shareholders of the company at a general meeting.

**Very Substantial Acquisition or Reverse Takeover** - If any of the relative figures computed as above is 100% or more, or if the transaction is one that would result in a change in control of the company, then the transaction should be made conditional upon the approval of the shareholders and the Exchange.
The company must also immediately make an announcement containing the information prescribed by the Listing Manual. In addition, the enlarged group must comply with the other requirements for very substantial acquisitions or reverse takeovers set out in the Listing Manual, many of which are similar to listing admission requirements.

**Acquisitions Involving Profit Guarantees**

Where the purchase consideration of businesses or assets given by a listed company is influenced by profit guarantees provided by the vendors, the Exchange requires directors of listed companies and their financial advisers to pay particular attention to the interests of shareholders. In assessing proposed acquisitions involving profit guarantees, the directors and their financial advisers should:

- assess whether the profit guarantee provided is realistic, taking into consideration the historical performance and future prospects of the businesses or assets to be acquired;
- assess the adequacy of compensation should the profit guarantee fail to materialize;
- put in place proper safeguards to ensure the company’s right of recourse when the profit guarantee is not met (such as the use of bankers’ guarantees or an escrow account to hold compensation consideration pending determination of whether profit guarantee has been met); and
- Ensure that the proposed acquisitions are in compliance with all relevant rules and regulations, including the Exchange’s requirements on very substantial acquisitions, major transactions and disclosable transactions.
Interested Person Transactions

Under the Listing Manual, transactions between a listed company (or its subsidiaries or associated companies) and its “interested persons” (i.e., its director, chief executive officer or controlling shareholders, or their respective associates) are known as “interested person transactions.” Depending on the size of such transactions, they may have to be immediately announced and may also be subject to the approval of the shareholders of the company.

An interested person transaction will need to be immediately announced if the value of the transaction is equal to, or more than, 3% of the group’s latest audited net tangible assets, whether computed on its own or when aggregated with other transactions entered into with the same interested person during the same financial year.

In addition to the requirement for immediate announcement, an interested person transaction will also need to be approved by the shareholders of the listed company if the value of the transaction is equal to, or more than, 5% of the group’s latest audited net tangible assets, whether computed on its own or when aggregated with other transactions entered into with the same interested person during the same financial year.

The above rules do not apply to any interested person transaction below SGD100,000.

The interested person and any associate of the interested person must not vote on the resolution approving the interested person transaction. In addition, an independent financial adviser will need to be appointed to advise whether the transaction is on normal commercial terms and is prejudicial to the interests of the listed company and its minority shareholders.
In practice, M&A laws in Singapore are a complex interplay of various regulations. It is advisable that proper professional advice be sought at every stage of the transaction to ensure that the proposed merger or acquisition is fully in compliance with the regulatory and legal regime currently in place in Singapore.
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Mergers and acquisitions ("M&A") are common transactions in corporate practice in Taiwan. Under Taiwan law, a merger generally refers to the consolidation of two or more companies into one existing (surviving) or new company. The term acquisition refers to the purchase by one company (buyer or acquiring company) of either the shares or assets of another company (target company).

Historically, cross-border M&A activities involved mostly private companies, largely due to the inflexibility in and certain restrictions on closing transactions involving public and listed companies. Since a number of these restrictions have been lifted and the inflexibility eliminated, M&A activities now increasingly involve public and listed companies. Public companies are companies duly limited by shares and registered with the Securities Futures Bureau as public companies. The term listed companies refers to public companies that are listed on the Taiwan Stock Exchange ("TSE") or Gre-Tai Securities Market ("Gre-Tai", formerly referred to as the Over-the-Counter Market).

Before the Enterprise Merger Law ("EML") was promulgated in February 2002, the legal regime in Taiwan was not conducive to M&A activities. From a tax perspective, a share purchase was generally preferred over an asset purchase or statutory merger because the former is only subject to securities transaction tax, whereas the latter is subject to income tax as high as 25% (although since 1 January 2010, the tax rate on gains for sale/purchase of assets is 17%). The EML gives companies additional ways to conduct M&A activities, such as statutory 100% share swaps, statutory spinoffs and statutory acquisitions of shares or assets. EML also provides a set of tax and other incentives (such as those relating
to employees, minority shareholders and/or creditors’ rights) for the above M&A activities not otherwise available under the Income Tax Law or other previous laws, on the condition that certain statutory requirements are met.

A significant development in the area of M&A is the government’s recent relaxation of regulations concerning investments from People’s Republic of China ("PRC"). Certain PRC investors are now allowed to invest in many types of businesses in Taiwan, spanning the manufacturing, service and infrastructure sectors. The Financial Supervisory Commission ("FSC") of Taiwan now allows direct investment by PRC investors in Taiwan securities listed on the TSE and the Gre-Tai. More recently, the FSC approved and passed draft amendments to the Regulations Governing Approvals of Banks to Engage in Financial Activities between the Taiwan Area and the Mainland (China) Area, Regulations Governing Approvals of Securities and Futures Transactions between the Taiwan Area and Mainland China Area, and to the Regulations Governing Approvals of Insurance Transactions between the Taiwan Area and the Mainland China Area. The amended regulations were promulgated and enforced on 18 March 2010.

The main amendments relate to rules and procedures governing the establishment of branches, representative offices or subsidiaries in China by Taiwan banks, and the setting up of representative offices in Taiwan by Chinese securities and futures businesses with more relaxed equity investment rules.

As this trend continues, inbound investment from PRC is expected to increase.
M&A can be effected through asset purchase, share purchase or merger. Within each of these categories, there are a variety of options, as outlined below.

**Typical Types of M&A Activities**

- **Share Purchase**
  - Traditional share purchase
  - Statutory 100% share swap under Article 29 of the EML
- **Asset Purchase**
  - Traditional asset purchase
  - Statutory acquisition of assets under Articles 27 or 28 of the EML
  - Public tender offer under Article 43-1 of the Securities Exchange Law
- **Merger**
  - Statutory spinoff under Article 32 of the EML
  - Statutory spinoff under Article 316 of the Company Law
  - Statutory merger under Articles 18-21 of the EML
  - Simple statutory parent-subsidiary merger

**Off-market transactions**

- Buying in the market during trading hours
- After-hour bulk trading
- After-hour fixed-price trading
- Public tender
- Public tender offer under Article 43-1 of the Securities Exchange Law
- Private placement
Share Purchase

Under current law, share purchases may be effected by any of the following methods:

**Traditional Share Purchase**

Existing shares of a private company can generally be sold and purchased free of legal restrictions (although the seller may be restricted by contractual obligations towards third parties). Share purchases of a public company are subject to a number of regulatory restrictions/regulations briefly described below. For instance, if a person, whether acting independently or in conjunction with another person or persons, intends to acquire 20% or more of the outstanding shares of a public company within a 50-day period, it must purchase the shares through a public tender offer, unless the company is deregistered as a public company and becomes a private company. A public tender offer is a straightforward and efficient way of purchasing shares and it enjoys the same tax advantages as a traditional share purchase. However, it is subject to certain regulatory requirements, such as government reporting and public notification (see Regulation of Public Tender Offers below).

Existing shares of a company listed on the TSE or Gre-Tai can be purchased by buying in the market during trading hours, bulk trading, after-hour fixed-price trading, public tender, public tender offer, private placement and, in relation to Gre-Tai, off-market transactions (see the section on Listed Company Considerations below).

Notwithstanding the tax implications that a share purchase may impose, in the form of a 0.3% securities transaction tax and a 10% (for individuals) or 20% (for corporations) Alternative Minimum Tax (see the section on Taxation Issues below), the main drawback of a share purchase transaction is that it involves a sale of the target company together with all its liabilities, including contingent or undisclosed liabilities. Therefore, buyers often insist on thorough due diligence and strict warranties and representations in the purchase agreement.

**Statutory 100% Share Swap Under Article 29 of the EML**

Under Article 29 of the EML, a company may acquire 100% of the outstanding shares of a target company by issuing new shares to swap with all of the target’s outstanding shares. The buyer, or issuing company, is exempt from deed tax, Value Added Tax (“VAT”), securities transaction tax and stamp duty for this kind of transaction, and land value increment tax is also deferred (see EML Special Tax Incentives below). After the share swap, the issuing company and its now 100%
owned target company may consolidate their income or losses for income tax purposes, with the issuing company being the sole taxpayer.

Asset Purchase

Unlike a share purchase, an asset purchase has historically involved a higher tax cost. While a traditional asset purchase is still viable in certain circumstances, the EML has broadened the landscape with other options.

Traditional Asset Purchase

Until recently, sellers were less inclined to agree to a traditional asset sale because this attracted higher tax costs (see Tax Liability Under a Traditional Asset Purchase below). Buyers, however, preferred an asset purchase because the liabilities of the target were seldom automatically transferred and buyers could contractually exclude the transfer and assumption of specific assets or liabilities of the target company that they did not wish to assume. In certain cases, prior consent of third parties may be required before certain assets, contracts of liabilities can be transferred. With the enactment of the EML, new options have emerged and have become favorable to both parties, giving the buyer certain opportunities to pick and choose while keeping the seller's taxes low.

Statutory Acquisition of Assets Under Articles 27 or 28 of the EML

Statutory acquisition of assets is now permitted under Articles 27 or 28 of the EML. These articles deal with the following transactions:

- A general assumption of assets and liabilities as defined in Article 305 of the Civil Code
- A transfer of the whole or essential part of a company's assets or business as defined in Article 185(1)[ii] of the Company Law
- Assumption of all of the assets or business of another company, which has a significant effect on the buyer’s own business as defined in Article 185(1)[iii] of the Company Law
- A wholly owned subsidiary issuing new shares as consideration for acquisition of the whole or essential part of the parent company's assets or business as defined in Article 28 of the EML

According to Article 4 of the EML, consideration for an asset acquisition may be cash, shares and/or other assets.
The EML permits exemptions of VAT, deed tax, stamp duty, and securities transaction tax and deferral of land value increment tax for certain qualifying transactions (see the section on EML Special Tax Incentives below).

The statutory asset acquisition option is favorable to both buyers and seller as it minimizes taxes, allows the buyer to exclude, to some extent, specific liabilities of the target company, and permits the carrying forward of favorable tax attributes of the target company to the buyer under certain circumstances (see EML Special Tax Incentives below).

Statutory Spinoff Under Article 317 of the Company Law or Article 32 of the EML

Prior to the EML, statutory spinoffs under Article 317 of the Company Law were not a favored option since they did not enjoy the tax benefits under the Company Law. Now, under Article 32 of the EML, a divesting company may spin off a business unit to an existing or newly incorporated company in exchange for shares of that company. Tax incentives for such an option are generally the same as those in statutory acquisitions of assets. However, in a spinoff, the company receiving the spun-off assets will become jointly and severally liable, to the extent of the value of the assets acquired, for any debts or obligations existing within a two year period prior to the date of the spinoff. This necessitates extensive due diligence on the buyer’s part.

Merger

Statutory Merger Under Article 316 of the Company Law or Articles 18-21 of the EML

A statutory merger of two companies limited by shares is possible under Article 316 of the Company Law or under Articles 18-21 of the EML. The surviving company can either be one of the existing companies or it may be a new company but, in either case, it must be a company limited by shares. Statutory mergers offer a number of benefits. For instance, as a general rule, a statutory merger does not require any third party consents or transfers. Additionally, following the enactment of the EML, statutory mergers have been generally accomplished without attracting tax liabilities (see EML Special Tax Incentives below).
If the target company is to be liquidated after the acquisition of its shares or assets, a statutory merger is preferable as it will not attract income tax upon the distribution of the remaining assets of the liquidated company. Further, the surviving entity can, in some cases, continue to enjoy the favorable tax attributes of the extinguished entity, such as exemption from income tax (e.g., for strategically-important industries) and investment tax credits.

**Simple Parent-Subsidiary Merger Under Article 316-2 of the Company Law or Article 19 of the EML**

If an acquiring company owns 90% or more of the outstanding shares of a target company, pursuant to Article 19 of the EML, the merger can be consummated, following a simple approval from the boards of the merging companies, as there are fewer shareholders requiring protection since the major shareholders will be acquiring the company. Article 316-2 of the Company Law provides similar procedures for simple parent-subsidiary merger.
The trend of management buyouts ("MBO"), (generally, the acquisition of a company by the management together with private equity firms), has raised concerns in Taiwan over the issue of conflict of interests.

An MBO commonly involves the privatization of a Taiwan company by way of: (i) a public tender offer and a subsequent merger under Articles 18-21 of the EML using cash and/or redeemable preferred shares as merger consideration ("Cash Merger") or statutory 100% share swap under Article 29 of the EML; (ii) statutory 100% share swap under Article 29 of the EML and a subsequent Cash Merger under Articles 18-21 of the EML; or (iii) one-step Cash Merger under Articles 18-21 of the EML.

The benefits of structure (i) are as follows:

- It is a faster way for shareholders to receive cash consideration.
- The remaining minority shareholders who do not accept the public tender offer are cashed out through the Cash Merger.
- Shareholders’ gains from the public tender offer are treated as capital gains, which is tax free (however, an alternative minimum tax is applicable to domestic corporate entity or individual shareholders).
- The securities transaction tax of 0.3% will apply (the tax basis of which is calculated on the value of proceeds received) in respect of the shares acquired through the public tender offer.
• Through the public tender offer, the management and the private equity firm may have sufficient votes to support the Cash Merger and if they acquire 90% or more shares in a Taiwan company through the public tender offer, a short-form Cash Merger will be available requiring only board approvals.

• Acquisition premiums can be allocated to assets acquired and can be amortized at stepped-up value to reduce future taxable income.

The shortcomings of structure (i) are as follows:

• A public tender offer requires a prospectus.

• Since under the EML, a Cash Merger will result in extinguishing one of the Taiwan companies, there may be material post-merger issues associated with a Taiwan company going out of existence, such as problems regarding survival of license, material IP, contracts or other rights, triggering severance payments or other material costs.

A privatization may be conducted by a consortium jointly invested by the management team of the Taiwan company and a private equity firm. However, when a consortium acquires certain shares of the Taiwan company through the tender offer, there is the issue of whether it is able to vote in the board meeting and shareholders’ meeting in connection with the subsequent merger or statutory 100% share swap. Paragraph 5, Article 18 of the EML explicitly provides that the consortium may vote in the board meeting and shareholders’ meeting when the consortium, which generally will set up an offshore Special Purpose Vehicle ("SPV"), intends to effect the merger of the SPV with the Taiwan company, thereby directly or indirectly holding the shares of the Taiwan company. By contrast, in relation to a statutory 100% share swap, which may potentially impair the interests of the Taiwan company, Articles 178 and 206 of the Company Law provide that the consortium should refrain from voting in the board meeting and shareholders’ meeting of the Taiwan company, making it a less feasible option in MBO transactions.

The benefit of a one-step Cash Merger outlined in (iii) is that there are no conflict of interest issues involved. However, the shortcoming is that the consortium may not be able to obtain sufficient voting shares to support the Cash Merger.

In addition to the issue of conflicts of interest, Taiwan regulators may also be concerned with the high leverage ratio inherent in MBO transactions that is likely to result in thin capitalization of the Taiwan company, qualification of the private equity firm, insider trading issues and potential plans to lay off employees.
Foreign Investment in Taiwan

Foreign investments are subject to Taiwan’s regulations on foreign investment. The relevant statute is the Statute for Investment by Foreign Nationals ("SIFN") and the competent authority is the Investment Commission ("IC") of the Ministry of Economic Affairs ("MOEA"). Under the SIFN, foreign investors must apply for and obtain Foreign Investment Approval ("FIA") from the IC in order to:

- establish a subsidiary or joint venture company;
- acquire shares from existing companies (other than those shares listed on the TSE or Gre-Tai); or
- increase the amount of equity investment in an enterprise.

The major incentives granted to FIA companies are:

- rights of repatriation of equity and loan investments, profits, interest and capital gains;
- waiver of resident and nationality requirements under the Company Law, the Mining Law, the Land Law, the Maritime Law and the Civil Aviation Law;
- no expropriation for a period of 20 years, as long as the foreign investor continues to hold at least 45% of the total capital of the FIA company;
- exemption from the requirements to issue 10% to 15% of the new shares to employees or the public, if at least 45% of the stock of an FIA company is foreign-owned;
• the dividend withholding rate is 20%; and
• exemption of income tax for expatriates who conduct pre-FIA activities and who meet certain residency requirements.

The IC maintains a Negative List (see Appendix A) that includes one category of industries in which foreign investment may be restricted by percentage (e.g., telecommunications) and another category in which foreign investment may be wholly prohibited (e.g., military products). The list is based on the relevant laws and regulations of Taiwan and is updated from time to time.

Depending on the category of the investment, the following estimated ranges represent the average time for obtaining an FIA:

• For investments other than the restricted industries in the Negative List and where the investment amount or increased capital is less than TWD500 million, two to four days

• For investments other than the restricted industries in the Negative List and where the investment amount or increased capital is at least TWD500 million but less than TWD1.5 billion, three to five days

• For investments falling under the category of restricted industries listed in the Negative List or where the investment amount is more than TWD1.5 billion, or where the investment is in connection with M&A or spinoffs, 10 to 20 days

• For investments in connection with international M&A or spinoffs, or other extraordinary applications, 20 to 30 days

The estimated timeframe can be extended at the discretion of the IC. To obtain an FIA, a foreign investor is required to submit a completed application form together with the required documents (such as an investment plan, a business operation plan, a shareholder list and investor’s information) to the IC for examination. The approval process is set out in the Approval Flow Chart for Investment Applications by Overseas Chinese or Foreign Nationals in Appendix B.

Opening up of China Investments in Taiwan

Until recently, PRC citizens and entities organized under the laws of the PRC were prohibited from investing, whether directly or indirectly, in Taiwan. However, since 2009, the Taiwan government has been adopted regulations that have made PRC investments in Taiwan possible. These include: Regulations Governing People’s Republic of China Investors’ Investment in Taiwan; Regulations Governing the Setup of Branches and Liaison Offices by PRC Profit-Seeking Enterprises in
Taiwan; the Approved List of Industries by PRC Investors’ Investment in Taiwan (Approved List). Inbound investments by PRC investors is allowed upon the approval of the IC.

According to the Approved List, PRC Investors are allowed to invest in 100 businesses of which 64 belong to the manufacturing sector; 25 to the services sector; and 11 to the infrastructure sector. For infrastructure businesses, there are restrictions on the shareholding percentage and total investment amount with respect to airport terminals and seaports.

In April 2009, the FSC promulgated Regulations Governing PRC Investors in Conducting Securities Investment and Futures Transactions (the “PRC Securities Investment Regulations”) which allowed direct investment in Taiwan securities listed on the TSE and the Gre-Tai.

In 2010, the FSC passed draft amendments to relax certain provisions of the Regulations Governing Approvals of Banks to Engage in Financial Activities between the Taiwan Area and the Mainland (China) Area, Regulations Governing Approvals of Securities and Futures Transactions between the Taiwan Area and the Mainland Area, and the Regulations Governing Approvals of Insurance Transactions between the Taiwan Area and the Mainland China Area. In particular, the amendments added provisions allowing cross-establishment of branch offices by relevant institutions from both Taiwan and Mainland China, and additionally clarified the requirements for PRC entities or entities with PRC shareholding to make investments in the financial, securities and futures and insurance businesses.

**Competition Law**

Under Taiwan’s Fair Trade Law ("FTL"), promulgated in February 1991 and last amended in November 2011, a Combination (as defined below) that meets certain statutory thresholds requires a prior notification to and approval from the FTC. A Combination is broadly defined in Article 6 of the FTL to include:

- an enterprise merging with another enterprise;
- an enterprise holding or acquiring the shares or capital contributions of another enterprise to an extent of one-third or more of the total voting shares or total capital of such an enterprise;
- an enterprise accepting the transfer of, or leasing from, another enterprise the whole or the principal part of the business or properties of such other enterprise;
• an enterprise operating jointly with another enterprise on a regular basis or being entrusted by another enterprise to operate the latter’s business; and
• an enterprise directly or indirectly controlling the business operation or the appointment or discharge of personnel of another enterprise.

The FTC has made clear in various rulings that an enterprise includes a foreign enterprise for purposes of the FTL.

Consequence of Failure to Notify the FTC

If a Combination that meets the statutory thresholds set out below is not notified in advance or if such a Combination is consummated prior to the expiration of the review period, the FTC may prohibit the Combination, set a time limit by which the parties must be split into separate enterprises, order the compulsory divestiture of assets and/or shares, order a compulsory discharge of personnel, adopt other necessary measures and impose an administrative fine between TWD100,000 and TWD50 million.

Threshold Requirements for Notifying FTC

For each of the above Combinations, if any of the following filing thresholds under Article 11 of the FTL is met, a prior notification is required to be filed with the FTC:

• The enterprises participating in the Combination (“participating enterprises”) will, through the Combination, achieve a market share in the said sector of one-third or more.
• Any of the participating enterprises, prior to the Combination, already has a market share of one-quarter or more in the said sector of the Taiwan market.
• The amount of revenue in Taiwan of the participating enterprises in the preceding fiscal year exceeds TWD10 billion and TWD1 billion respectively for non-financial institutions, and TWD20 billion and TWD1 billion for financial institutions. (Note that filing is required once one company meets the upper threshold and the other meets the lower threshold.)

According to Article 11-1 of the FTL, Combinations are exempted from the FTC filing obligation if:

• any of the participating enterprises already holds 50% or more of the voting shares or capital contribution of another enterprise in the Combination and combines with such other enterprise;
Guide to Mergers and Acquisitions

- 50% or more of the voting shares or capital contribution of the participating enterprises is held by the same parent enterprise;

- an enterprise assigns all or an essential part of its business or assets, or all or part of its independently operable business to another separate and new enterprise solely established by that original enterprise; or

- an enterprise decreases the amount of its issued outstanding shares by purchasing treasury shares pursuant to the Company Law or the Securities Exchange Law ("SEL") and, as a result of such decrease, causes an original shareholder to hold one-third or more of the voting stock of, or interest in, the enterprise.

Factors to be taken into Account during FTC Review

In its review of a Combination application, the FTC will determine whether the advantages to the national economy derived from the Combination outweigh the disadvantages to the competition constraint. If it decides that the advantages outweigh the disadvantages, the Combination will be approved. The FTC will consider the following factors in ascertaining the disadvantages resulting from the Combination:

- Whether the company after Combination may monopolize or dominate the market

- Whether the Combination will create or establish additional barriers to entry into the relevant market

- Whether the Combination will change the market structure and the degree of market concentration

In determining whether a Combination brings any advantages, to the overall economy, the FTC generally takes into account factors such as cost reduction, technological/operational efficiency and improvement to the performance of the business. During the review period, the FTC may announce the Combination filing on its website and invite comments from the public. If the Combination is likely to have a significant impact on the market, the FTC may hold a public hearing for purposes of inviting public opinion and comments.

FTC Review Procedure

The FTC may adopt either the expedited procedure or the regular procedure to review Combination filings.
When reviewing a prior notification, the FTC will consider the following factors: volume of sales of the parties to the Combination; market shares of the parties to the Combination; production and inventory; import and export volume; and the nature of the relevant markets.

The FTC adopts expedited procedures in the following cases:

- If the enterprises that file application for a Combination with the FTC fall within the revenue threshold under Article 11.1.3 of the FTL and where their respective market shares fall into one of the following circumstances:
  - in a horizontal Combination, the combined market share after the Combination is less than 20%; except where the market share of the two largest enterprises in certain specified markets is two-thirds of the relevant market or the market share of the three largest enterprises is three-quarters of the relevant market; or
  - in a vertical Combination, the combined market share after the Combination in each individual market is less than 25%.

- In the case of conglomerate combinations, where there is no possibility of significant potential competition between the combining parties, subject to the following factors:
  - the impact of relaxation of regulations and control on cross-industry operation by the combining parties;
  - probability of cross-industry operation by the combining parties due to technology advancement;
  - original cross-industry development plans of the combining parties other than the Combination itself; or
  - other factors that affect the likelihood of material potential competition.

- Combinations between a controlling enterprise and its subsidiary that changes the manner of their relations such as:
  - one of the enterprises participating in the Combination directly owns more than one-third and less than one-half of the voting shares or paid-up capital of the other combining party;
  - a company combines with another company having controlling and subordinate relation with the former company;
  - a company combines with another company, which is also a subordinate company of the former company’s controlling company;
- a company transfers part or all of the shares or capital contributions of another enterprise to its controlling or subordinate company; or
- a company transfers part or all of the shares or capital contributions of another enterprise to a company which is also a subordinate company of the former company’s controlling company.

Even if the filings meet the above criteria to qualify for expedited procedures, the regular procedures may still be applicable if the FTC deems that:

- The Combination involves major public interest.
- One of the combining parties is a “holding company” as defined in the Taiwan Stock Exchange Corporation Regulations for the Review of Stock Exchange Listings Applications by Investment Holding Companies or the Financial Holding Company Act.
- There is difficulty in delineating the scope of the relevant market or the calculation of market shares of companies participating in the Combination.
- The relevant market of companies participating in the Combination has high entry barriers, market concentration or other unfavorable and questionable circumstances that severely limit competition.

The combining enterprises shall submit a completed application form and the relevant required documents (such as the information of the combining enterprises and the information of respective market shares) to the FTC for review.

Under the FTL, enterprises may not close the Combination within a period of 30 days from the date on which the FTC accepts their completed Combination application. The FTC may request an extension not exceeding 30 days. The FTC may attach conditions or require undertakings in any of the decisions it renders in order to ensure that the overall economic benefit of the Combination outweighs the disadvantages resulting from any restraint in competition.

Although some high profile M&A activities have attracted media attention over their competitive effects on the relevant markets or industries in Taiwan, thereby resulting in FTC scrutiny, in practice, most Combination applications do not encounter objection by the FTC.
Offshore Combination

In August 2000, the FTC rendered a regulation related to offshore Combinations, the Handling Principles Regarding Offshore Combinations (the “Principles”), the latest amendment of which was made in March 2012. The term Offshore Combinations, as used in the Principles, means a combination of two or more foreign enterprises outside of Taiwan, which falls within the scope of Article 6 of the FTL.

According to the Principles, an Offshore Combination will still require a prior notification to the FTC if it meets the statutory thresholds in Article 11. Thus, Article 11 of the FTL is applicable to foreign enterprises as well.

The following factors are considered when deciding whether an Offshore Combination is subject to FTC review:

- Its relative impact on Taiwan and foreign markets
- The nationality, residence and principal place of business of each participating enterprise
- The clarity and predictability of the intent to affect Taiwan’s market competition through the Combination
- The possibility of conflict with the laws or policies of the countries of the combining enterprises
- The possibility of enforcing administrative decisions
- The impact of enforcement upon foreign enterprises
- The regulatory scheme of the applicable international treaties, agreements or international organizations
- Other elements deemed important by the FTC

The Principles state that the FTC should not exercise jurisdiction over an Offshore Combination if neither of the participating enterprises has any equipment for performing manufacturing or providing services, or has distributors, agents or other substantial sales channels in the territory of Taiwan. The FTC will also not exercise jurisdiction over an Offshore Combination which fulfills the thresholds but has no direct, substantial, and reasonably foreseeable impact on the Taiwan market, such as where there are no overlapping industries. However, as this is considered on a case-by-case basis, in practice, a prior notification is still required to be filed with the FTC.
Exchange Controls

Taiwan exercises foreign exchange controls over inward and outward remittances. The control only applies to the conversion of foreign exchange into local currency or vice versa, but not to the ownership of foreign currency.

Foreign exchange settlement can be made through a foreign exchange bank by submitting to the Central Bank of the Republic of China (Taiwan) (“CBC”) a Foreign Exchange Payment or Receipt Transaction Declaration Form accompanied by the necessary evidentiary documents pertaining to the payment or receipt. Prior approval of the CBC is not required for the following payments or receipts:

- Revenue from exports of goods or provision of services
- Payments for the import of goods or payments made by registered entities for compensation of service expenses
- Revenue from, or expenditures (e.g., remittance of dividends or profits) on, direct investment (e.g., inbound equity investments) approved by the MOEA
- Aside from the above purposes, where the aggregate remittance by a resident entity or branch office during a calendar year is within USD50 million; where the aggregate remittance by a resident individual during a calendar year is within USD5 million; or where each remittance by a non-resident individual or entity is within USD100,000 (Note that these ceilings are subject to change by the CBC from time to time.)

All other remittances require the prior approval of the CBC, which is generally difficult to obtain.
Taxation issues are among the primary concerns for companies considering engaging in M&A. From a tax perspective, a share purchase is generally preferred over an asset purchase or merger. This is because the purchase of the shares of a Taiwan target company is subject only to securities transaction tax and the new Alternative Minimum (Income) Tax, and there is currently no capital gains tax on the sale of shares. Though capital gains tax will be resumed after 1 January 2013, the tax cost under a share purchase will still be lower than under an asset purchase.

The following chart outlines the main tax issues, including new tax incentives for M&A activities under the EML, that are relevant in a merger, or a share or asset acquisition in Taiwan. These issues are discussed in detail below.
### A Comparison of Tax Liability for M&A Activities

<table>
<thead>
<tr>
<th>Tax Considerations</th>
<th>Share Purchase</th>
<th>Asset Purchase</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The taxes below are payable by the sellers.</strong> <em>(The amortization of costs and goodwill are concerns of the buyers)</em></td>
<td>Traditional share purchase</td>
<td>Statutory 100% share swap under Article 29 of the EML</td>
</tr>
<tr>
<td><strong>Income tax</strong></td>
<td>Corporation: 10% Alternative Minimum Tax (&quot;Alt. Min. Tax&quot;) on gains from share sale of listed or unlisted companies Individual: 20% Alt. Min. Tax on gains from share sale of unlisted companies</td>
<td>Corporation: 10% Alt. Min. Tax on gains from share sale of listed or unlisted companies Individual: 20% Alt. Min. Tax on gains from share sale of unlisted companies</td>
</tr>
<tr>
<td><strong>Capital gains tax</strong></td>
<td>None - gains taxed as ordinary income</td>
<td>None - gains taxed as ordinary income</td>
</tr>
<tr>
<td><strong>Securities transaction tax</strong></td>
<td>0.3% of sale proceeds</td>
<td>Exempt</td>
</tr>
<tr>
<td><strong>Stamp, deed, VAT, land value increment tax (&quot;LVIT&quot;)</strong></td>
<td>Not applicable</td>
<td>Stamp, deed, VAT tax exempt and LVIT deferred if the voting shares of the acquiring company comprise at least 65% of the consideration given</td>
</tr>
<tr>
<td><strong>Net operating loss (&quot;NOL&quot;) of the preceding five years carryover</strong></td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
<tr>
<td><strong>Amortization of Costs</strong></td>
<td>Costs of M&amp;A activities amortized over 5 years</td>
<td>Costs of M&amp;A activities amortized over 10 years</td>
</tr>
<tr>
<td><strong>Amortization of Goodwill</strong></td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
</tbody>
</table>

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1. An additional 15-year amortization of loss may be available where the value of the acquired shares is less than the book value of the business/assets.
2. An additional 15-year amortization of loss may be available for losses from sales of bad debt claims.
## A Comparison of Tax Liability for M&A Activities

**Stamp, deed, VAT, land value**
- Capital gains tax
- Considerations

- An additional 15-year amortization of loss may be available for losses from sales of bad debt claims.
- An additional 15-year amortization of loss may be available where the value of the acquired shares is less than the book value of the business/assets.

### Tax Considerations

- **Traditional statutory spinoff under Article 317 of the Company Law**
  - No benefits
  - Costs of M&A activities amortized over 10 years

- **Statutory spinoff under Article 32 of the EML**
  - No benefits
  - NOL carryover in proportion to the share-swap ratio of the division

- **Traditional statutory merger under Article 316 of the Company Law**
  - No benefits
  - Losses from debts incurred from the merger transaction may be carried over

- **Statutory merger under Articles 18-21 of the EML**
  - No benefits
  - NOL carryover in proportion to the share-swap ratio of the merger

- **Simple statutory parent subsidiary merger under Article 316(2) of the Company Law**
  - No benefits
  - NOL carryover in proportion to the share-swap ratio of the merger

- **Traditional simple statutory parent-subsidiary merger under Article 19 of the EML**
  - No benefits
  - NOL carryover in proportion to the share-swap ratio of the merger

<table>
<thead>
<tr>
<th>Merger</th>
<th>Spinoff</th>
<th>Traditional statutory merger under Article 316 of the Company Law</th>
<th>Statutory merger under Articles 18-21 of the EML</th>
<th>Simple statutory parent-subsidiary merger</th>
</tr>
</thead>
<tbody>
<tr>
<td>None - gains taxed as ordinary income</td>
<td>None - gains taxed as ordinary income</td>
<td>None - gains taxed as ordinary income</td>
<td>None - gains taxed as ordinary income</td>
<td>None - gains taxed as ordinary income</td>
</tr>
<tr>
<td>Not applicable</td>
<td>Exempt</td>
<td>0.3% of proceeds from sale of shares</td>
<td>Exempt</td>
<td>Exempt</td>
</tr>
<tr>
<td>No benefits</td>
<td>Stamp, deed, VAT tax exempt and LVIT deferred</td>
<td>Stamp, deed, VAT tax exempt and LVIT deferred</td>
<td>Stamp, deed, VAT tax exempt and LVIT deferred</td>
<td>Stamp, deed, VAT tax exempt and LVIT deferred</td>
</tr>
<tr>
<td>No benefits</td>
<td>NOL carryover in proportion to the share-swap ratio of the division</td>
<td>Losses from debts incurred from the merger transaction may be carried over</td>
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<td>NOL carryover in proportion to the share-swap ratio of the merger</td>
</tr>
<tr>
<td>No benefits</td>
<td>Costs of M&amp;A activities amortized over 10 years</td>
<td>Costs of M&amp;A activities amortized over 5 years</td>
<td>Costs of M&amp;A activities amortized over 5 years</td>
<td>Costs of M&amp;A activities amortized over 10 years</td>
</tr>
<tr>
<td>No benefits</td>
<td>Amortized over 15 years</td>
<td>Amortized over 15 years</td>
<td>Amortized over 15 years</td>
<td>Amortized over 15 years</td>
</tr>
</tbody>
</table>
Income Tax

Capital gains realized on the sale of a Taiwan company’s shares are currently tax exempt for ordinary income tax purposes. However, income generated from share sales may be subject to a 10% or 20% Alternative Minimum Tax ("AMT"), which came into effect on 1 January 2006. An individual shareholder (seller) will be subject to a 20% AMT on gains from the transfer of investment in an unlisted target company while a corporate shareholder will be subject to a 10% AMT on gains from the transfer of investment in either a listed or unlisted company. Effective 1 January 2013, individual shareholders will be subject to regular income tax of 15% for capital gains. In addition, the AMT rate for corporate shareholders will be raised to 12%.

Domestic individual shareholders are also subject to personal income tax on dividends. However, such shareholders may credit the tax paid on profits at the company level against their annual individual income tax liabilities. Dividends payable to domestic corporate shareholders are tax free. Dividends payable to foreign individual or corporate shareholders are subject to 20% withholding tax.

Traditionally, a sale of assets gives rise to a 17% income tax on realized gains on the sale. The current legal regime enables companies to use certain tax incentives enacted under the EML to reduce tax liability for these types of acquisitions. The EML permits the exemption and consolidation of income for qualifying merger, asset acquisition, spinoff and share swap transactions (see the section on EML Special Tax Incentives below).

Tax Liability Under a Traditional Asset Purchase

Historically, the purchase of a target company’s assets may have given rise to liability for income tax at 17% on the gains or premiums received from the sale of assets, personal income tax, a 5% business tax (VAT) (payable by the seller), a 20% to 40% land value increment tax (payable by the seller), a 6% deed tax (payable by the buyer), a 0.1% stamp duty, and notarization fees. However, various Company Law amendments and, more significantly, the EML, have introduced a number of tax incentives for asset purchases and other kinds of M&A activities (see EML Special Tax Incentives below).
Transactional Tax

Capital Gains Tax

No capital gains tax is imposed on mergers, sale of shares or sale of assets. Rather, gains arising from sale of shares or assets are taxed as ordinary income. Effective 1 January 2013, capital gains tax will be resumed (see the section Income Tax above).

Share Transaction Tax

A securities transaction tax (currently 0.3% of the sale proceeds) is imposed on the sale of shares but not on asset purchases or mergers under the EML.

EML Special Tax Incentives

The EML encourages M&A activities in Taiwan by offering various tax incentives. These tax incentives are also available to a foreign company engaging in a merger, acquisition, spinoff or 100% share swap with a domestic company, as those transactions are defined under the EML.

Special Incentives for Asset Purchases

Although certain M&A activities such as mergers and share purchases enjoyed certain tax benefits under the Company Law that were later enhanced under the EML, asset purchases have gained the most tax benefits under the EML, as previously they were not eligible for any M&A tax incentives (see the previous section on Tax Liability Under a Traditional Asset Purchase).

Stamp, Deed, VAT and Land Value Increment Tax

Under the EML, stamp duty, deed tax and VAT may be exempted and the land value increment tax may be deferred in the following cases:

- The transaction is conducted pursuant to Article 27 or 28 (Statutory Acquisition of Assets) or Article 29 (Statutory 100 Percent Share Swap) of the EML and voting shares of the acquiring company comprise at least 65% of the consideration given; or
- The transaction is conducted pursuant to Article 32 (Statutory Spinoff) or Articles 18 to 21 (Statutory Merger and Simple Statutory Parent-Subsidiary Merger) of the EML.
Income and Loss

Under Article 39 of the EML, any income of a company arising out of a sale of all or a substantial portion (50% or more) of its assets or business and where the voting shares of the acquiring company comprise 80% or more of the consideration for such sale, shall be exempt from the company’s income for income tax purposes. However, losses arising out of such transactions may not be deducted.

Additionally, under Article 40 of the EML, if, after a merger, acquisition, spinoff or share swap under the EML, a company owns 90% or more of the outstanding shares or capital contribution of a subsidiary, the company and its subsidiary may consolidate their income or losses for income tax purposes, with the company being the sole taxpayer.

NOL Carryover

Under Article 38 of the EML, the EML allows companies to carry forward net operating losses ("NOL") of the merging companies in proportion to the share-swap ratio of the merger. The NOL may be credited against the yearly net income of the new or surviving entity for any NOL that occurred within the preceding five years.

Amortization

Under Article 35 and 36 of the EML, goodwill arising out of a merger or acquisition may be amortized evenly over 15 years, while costs of M&A activities may be amortized evenly over 10 years. Amortization for goodwill and activity costs were available prior to the EML; however, costs of M&A activities were previously granted a shorter amortization period of five years.

Goodwill from Mergers Not Taxable

The long-awaited tax ruling on assets stepped-up from mergers was promulgated on 17 October 2008.

For the acquisition of publicly-listed Taiwan companies, typically, an SPV is established to acquire a majority shareholding in the Taiwan company. The SPV will then merge with the acquired company and stay as the surviving company. Assets will be stepped up and recorded in the surviving company’s accounts and most of them will normally be accounted as goodwill. Whether such assets step-up is taxable and who shall be taxable is unclear. On 4 January 2008, the Ministry
of Finance ("MOF") ruled that the extinguished company shall pay tax for fixed assets step-up. This ruling effectively forced the buyer to pay tax for the step-up value because the buyer is the majority shareholder upon merger. It remains to be seen whether the MOF will go beyond fixed assets and demand the extinguished company be taxed for other step-ups, especially goodwill.

Because capital gains on the sale of shares (but not on the sale of assets), is exempt from tax, sellers invariably prefer to structure the transaction as a sale of shares. Furthermore, when an SPV established for the acquisition is subsequently merged with the target company and the goodwill that results from the merger may be amortized over 15 years to offset against future taxable income. The new ruling of the MOF dated 17 October 2008, stipulates that any assets step-up will be taxed as deemed dividends to the shareholders of the extinguished company. As dividends from one Taiwan company to a Taiwan corporate shareholder are tax free, this new ruling will ease the market concern over taxability of the goodwill and is expected to make such two-step acquisition of Taiwan companies almost the preferred choice from a tax perspective.
M&A activities in Taiwan give rise to issues regarding the transfer of employees, payment of severance, mass redundancy and the assumption of accrued pension obligations of the target company. Employment issues related to reorganization or transfers of business entities are generally governed by Article 20 of the Labor Standards Law ("LSL"). However, the EML includes employment provisions, some of which differ from the relevant LSL provisions, which govern those activities that fall under the EML’s definition of the terms merger, acquisition or spinoff. The EML provisions benefit employers engaged in M&A, as they create procedural certainties with regard to notices of employee transfer, increased flexibility in meeting employee severance requirements, as well as the possibility to transfer the pension reserves of the target company in proportion to the employees being transferred.
# Employee Transfer Requirements for M&A Activities Under the LSL and EML

<table>
<thead>
<tr>
<th>Types of Transactions Subject to Regulation</th>
<th>LSL</th>
<th>EML</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfers of employees where the business entity is reorganized or ownership thereof is changed (According to a ruling issued by the Council of Labor Affairs (&quot;CLA&quot;) and Supreme Court precedents, “change of ownership” refers to the situation where following the transfer of all assets or equipment, the target company is dissolved. If after the transfer of assets or equipment, the target company’s legal entity still exists, this LSL provision will not apply.)</td>
<td></td>
<td>Transfers of employees in transactions that meet the EML definition of merger, acquisition or spinoff</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Employees to be Retained</th>
<th>LSL</th>
<th>EML</th>
</tr>
</thead>
<tbody>
<tr>
<td>The existing and the new employer may negotiate with respect to the employees to be retained. Decision to retain the employees is not specifically regulated in the LSL.</td>
<td></td>
<td>Both companies may consult with each other to reach a mutual decision with respect to the employees to be retained.</td>
</tr>
<tr>
<td>Notice of Transfer</td>
<td>LSL</td>
<td>EML</td>
</tr>
<tr>
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<tr>
<td>Issued by both companies. It must specify whether existing employment terms and conditions will be amended. While the LSL does not stipulate whether new terms and conditions need to be enclosed, the CLA states that the new employer should inform the to-be-retained employees about the new employment terms or negotiate a new employment agreement. It is advisable that at least a summary of the new terms and conditions should be enclosed along with the notice of transfer to the to-be-retained employees.</td>
<td>Issued by the new employer/company. New employment terms and conditions must be attached.</td>
<td></td>
</tr>
</tbody>
</table>

| Response to Notice of Transfer | No set time frame | 10 days from date of notice of transfer, or deemed acceptance if no response within the aforementioned time frame |

<p>| Severance Payments | The employee is entitled to severance only if the employee is not offered the new employment or declines the offer to transfer. | The employee is entitled to severance only if the employee is not offered the new employment or declines the offer to transfer. Any employee having accepted the new employment offer based on their express or implied consent but later refuses to be transferred to the new employer for any personal reasons whatsoever is prevented from requesting any severance pay from the current employer. |</p>
<table>
<thead>
<tr>
<th><strong>Recognition of Seniority</strong></th>
<th>LSL</th>
<th>EML</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seniority shall be recognized by the new employer.</td>
<td>Seniority shall be recognized by the new employer.</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Pension Fund</strong></th>
<th>LSL</th>
<th>EML</th>
</tr>
</thead>
<tbody>
<tr>
<td>A company that closes its business or is liquidated under a merger shall use its pension fund to make retirement payments and/or severance payments but retain the right to any remainder and is not required or allowed to transfer its pension fund to the new employer.</td>
<td>A company that is liquidated under a merger, acquisition or spinoff shall use its pension fund to make retirement payments and/or severance payments, and any remainder shall be transferred to the new employer, in whole or pro rata.</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Employees to be Laid Off</strong></th>
<th>LSL</th>
<th>EML</th>
</tr>
</thead>
<tbody>
<tr>
<td>There must be cause for termination pursuant to Article 11 of the LSL (e.g., closure of business or transfer).</td>
<td>The mandatory requirements under Article 11 of the LSL shall still be applicable.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Notice of Termination</strong></th>
<th>LSL</th>
<th>EML</th>
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<tbody>
<tr>
<td>The old employer must provide any worker to be laid off 10 to 30 days’ (depending on the length of service) advance notice of termination.</td>
<td>The old employer must provide any worker to be laid off 10 to 30 days’ (depending on the length of service) advance notice of termination.</td>
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<table>
<thead>
<tr>
<th><strong>Severance Payments</strong></th>
<th>LSL</th>
<th>EML</th>
</tr>
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<tbody>
<tr>
<td>Severance is equal to the amount calculated by using one month’s salary per year of service under the Old Pension Scheme, and 0.5 month’s salary per year of service under the New Pension Scheme.</td>
<td>Severance is equal to the amount calculated by using one month’s salary per year of service under the Old Pension Scheme, and 0.5 month’s salary per year of service under the New Pension Scheme.</td>
<td></td>
</tr>
</tbody>
</table>
Mergers

Although it is generally not possible to make severance payments out of the employees’ pension fund under the LSL, the CLA has permitted this where the employer, company is to be liquidated.

The EML governs transfers of employees in certain merger transactions. In a merger under the EML, the pension fund of the dissolving company (or a part of it in proportion to the number of employees to be transferred) must be transferred to the new or surviving company. The dissolving company must appropriate in full to the pension fund the amount due according to labor laws and regulations before transferring the pension fund to the new or surviving company. However, most of the pension funds maintained by companies in Taiwan are not sufficiently funded. The pension fund requirement often turns out to be an issue for companies contemplating a merger in Taiwan. The EML does not provide any penalty clause against companies that fail to comply with the requirement to appropriate in full the amount due in the pension fund. Therefore, in practice, some companies in M&A transactions do not actually transfer the funds in the pension reserve account but only use it as a factor to adjust the transaction price.

Acquisitions

Share Purchase

Since the purchase of shares does not change the employer-employee relationship of the buying and selling entities, this type of acquisition does not by itself give rise to labor concerns under the LSL or the EML.

Asset Purchase

Unlike share purchases or mergers, asset purchases may be governed by either the EML or Article 20 of the LSL, depending on the scale of the purchase. Article 20 of the LSL generally applies to transfers of employees where a business entity is reorganized or changes ownership. The CLA as well as the Supreme Court have interpreted that an acquisition (change of ownership) is recognized under the LSL where all of the rights of the original legal entity are transferred or extinguished. In contrast, the EML applies to transfers of employees in any company transaction that meets the EML-specific definition of merger, acquisition or spinoff. Acquisition is defined as the acquisition of shares, business or assets of another company in exchange for shares, cash or other assets in accordance with the relevant laws. As such, there may be cases where EML may impose labor
requirements on certain transactions that might not otherwise trigger regulation under Article 20 of the LSL, such as M&A activities that involve asset purchases of less than 100% of a company’s assets.

Though the EML mirrors some LSL provisions, it expands the scope of companies that are subject to regulation (as detailed in the table above) to include companies involved in asset purchases. Companies interested in conducting a statutory acquisition of assets or spin-off (thereby enjoying various EML tax incentives) should pay special attention to EML employment requirements, since such transactions would likely be classified as acquisitions under the EML.

The EML requires that the company divesting its assets or business give advance notice of the transaction and pay pension and/or severance payments to employees who are not offered employment after the acquisition or spinoff. For employees continuing employment after the acquisition or spinoff, the company divesting its assets or business must appropriate to the employees’ pension fund the full amount due under the relevant labor laws and regulations before transferring the pension fund to the acquiring company or to the spun-off company. Nevertheless, as indicated, the EML does not provide any penalty clause against companies that fail to comply with the requirement to appropriate the amount due in the pension fund.

Merger of Financial Institutions

The Law Governing Merger of Financial Institutions governs mergers between banking enterprises, securities and futures enterprises, institutions covered by the insurance enterprise and other institutions approved by the competent authority. According to Article 19 of this Law, when a financial institution undergoes merger, reorganization or assignment, the rights and interests entitled to its employees shall be handled in accordance with the LSL. Furthermore, the EML also specifically provides that it will defer to the provisions of the Law Governing Merger of Financial Institutions in cases of merger or acquisition by a financial institution.
Protective Act for Mass Redundancy of Employees

The Protective Act for Mass Redundancy of Employees, promulgated in February 2003 and amended in May 2008, will apply to M&A activities in any of the following circumstances:

- The target company has fewer than 30 employees and intends to lay off 10 or more employees within 60 days;
- The target company has more than 30 employees but less than 200 employees and intends to lay off more than 20 employees within one day or more than one-third of the total number of employees within 60 days;
- The target company has more than 200 employees but less than 500 employees and intends to lay off more than 50 employees within one day or more than one-quarter of the total number of employees within 60 days; or
- The target company has more than 500 employees and intends to lay off one-fifth of the total number of its employees within 60 days.

If the transfer of the target company’s employees will result in any of the circumstances listed above, the target company must notify the competent authority and relevant parties of its redundancy plan in writing and also notify the public by publishing an announcement 60 days prior to such occurrence. Furthermore, within 10 days from the date of submission of the mass redundancy plan, the target company and its employees shall enter into negotiations on the redundancy plan. If the employees and/or target company refuse to enter into negotiations or cannot reach an agreement, the competent authority shall, within 10 days after such unsuccessful negotiation or agreement, invite the employees and target company to form a negotiation committee to negotiate the terms of the redundancy plan and propose alternatives as appropriate.

Because the statutory procedures for mass redundancy are onerous, the employment layoff schedule in an M&A transaction should be well organized so that the mass redundancy circumstances listed above can be circumvented. Alternatively, the target company is advised to offer enhanced severance packages and enter into mutual termination agreements with the affected employees rather than subject them to layoffs.
Acquiring TSE and Gre-Tai Shares from the Market

In Taiwan, public companies can be listed on the TSE or the Gre-Tai. The shares of a target listed company can be acquired in the following ways.

<table>
<thead>
<tr>
<th>TSE</th>
<th>Gre-Ta-</th>
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<tbody>
<tr>
<td>• Buying in the market during trading hours</td>
<td>• Buying in the market during trading hours</td>
</tr>
<tr>
<td>• Bulk trading</td>
<td>• Bulk trading</td>
</tr>
<tr>
<td>• After-hours fixed-price trading</td>
<td>• After-hours fixed-price trading</td>
</tr>
<tr>
<td>• Public Tender</td>
<td>• Public Tender</td>
</tr>
<tr>
<td>• Public Auction</td>
<td>• Public tender offer under Article 43-1 of the SEL</td>
</tr>
<tr>
<td>• Public tender offer under Article 43-1 of the SEL</td>
<td>• Private placement</td>
</tr>
<tr>
<td>• Private placement</td>
<td>• Off-market transactions</td>
</tr>
</tbody>
</table>

Bulk Trading

Bulk trading may be conducted in different periods during or after normal trading hours every trading day. In each period, the buyer or seller may place a bulk order for listed shares at a price within a 7% deviation from the previous day's...
closing price. The bulk order for the shares of one target company must be for at least 500 transaction units of shares (or 500,000 shares assuming each unit is 1,000 shares) or shares amounting to at least TWD15 million. The bulk order for the shares of five target companies or more must have a total value of TWD15 million or more. Since 28 May 2007, bulk trading can be conducted by paired trade (provided that the seller is not a director, supervisor, manager or 10% shareholder of the target company), where the seller and buyer can negotiate in advance the amount and price. The bulk order transactions may be settled on the same day or the second business day after the transactions.

After-Hours Fixed-Price Trading

An investor may place orders for the market shares after normal trading hours (i.e., after 1:30 p.m.) at the closing price on the trading day if no more than 499 transaction units (or 499,000 shares assuming each unit is 1,000 shares) are acquired per order per day. Unlike bulk order transactions, an after-hours fixed-price transaction is settled within two business days following the transaction.

Public Tender

An investor may file an application with terms and conditions of the proposed public tender with the TSE to purchase a certain number of listed securities. The TSE will publicly announce the terms and conditions of the proposed public tender three days before the tender date upon its acknowledgement of the application. The tender price must be within a 15% deviation from the closing price of the trading day prior to the public tender date.

Public Auction

An investor may buy the TSE-listed shares in response to a public auction initiated by the target company’s shareholder(s). Such shareholder should first file an application with the terms and conditions of the proposed auction with the TSE for the public auction of his or her shares. Following receipt of the application, the TSE will publicly announce the terms and conditions of the auction three days before the auction date. The number of shares to be auctioned in one application should be no less than 2 million. The auction price must be limited to within a 15% deviation from the closing price on the trading day prior to the auction date. Gre-Tai-listed shares may not be acquired through public auction.
Off-Market Transactions

Though TSE- and Gre-Tai-listed companies follow similar on-the-market acquisition procedures, acquisitions of Gre-Tai-listed companies can additionally be achieved through off-market trading through securities dealers. Off-market trading gives companies the flexibility of negotiating acquisition terms, such as the share price, without the normal Gre-Tai market restrictions. However, certain foreign investors may be precluded from trading off-market those Gre-Tai securities that are subject to foreign ownership restrictions.

Acquisition of Market Shares by a Foreign Investor

Except for acquisitions of at least 10% of the shares of the listed company in a single transaction, where a prior foreign investment approval is required, a foreign investor may purchase listed shares from the TSE or Gre-Tai through a Foreign Institutional Investor (“FINI”) account registered with the TSE.

Restriction on Selling the Listed Shares on the Markets by an Insider

An insider, that is, a director, supervisor, managerial officer or shareholder holding more than 10% of the total shares of a listed company (see Special Restrictions on Selling Shares of a Listed Company - Insider Trading below), may sell his or her shares on the TSE or Gre-Tai after holding the shares for more than six months, subject to the daily sale amount restriction (see below). The calculation of shares held by the insider includes shares held by his or her spouse and minor children and those held under the names of other parties. The insider is required to report to the Securities and Futures Bureau of the Financial Supervisory Commission of Taiwan (the “SFB,” previously known as the Securities and Futures Commission) three days prior to the date he or she intends to sell the shares. However, the reporting requirement and the daily sale amount restriction do not apply to sales of less than 10,000 shares per day. The daily sale amount ceiling is derived by using either one of the following formulas:

- Where the total number of issued shares of the listed company does not exceed 30 million shares, the aggregate number of shares that the insider may sell per day is 0.2% of the 30 million shares (i.e., 60,000 shares) plus 0.1% of the number of shares exceeding 30 million shares; or
- 5% of the average number of the listed shares being traded on the market within 10 business days prior to the reporting day.
The above daily sale amount restriction may be exempted if the insider’s shares are sold via bulk trading, after-hours fixed-price trading, public tender, public tender offer and public auction. In relation to off-market transactions, the insider may only sell shares to a securities dealer, the employees of the listed company or other investors prescribed by the SFB. If a foreign insider intends to sell listed shares, which were initially acquired with a foreign investment approval, to another foreign investor, the above restriction will not apply as long as a foreign investment approval of the transfer has been obtained in advance.

Acquiring Privately Placed Securities

Under the SEL, an investor who falls under any of the following categories may subscribe for the new securities issued by a public company through private placement:

- Banks, bills finance enterprises, trust enterprises, insurance enterprises, securities enterprises or other legal entities or institutions approved by the competent authority ("Qualified Financial Institutions")
- Natural persons, legal entities or funds meeting the conditions prescribed by the competent authority ("Qualified Natural Persons/ Juristic Persons/Funds")
- Directors, supervisors and managerial officers of the issuing company or its affiliated enterprises ("Qualified Management")

The SEL further restricts the subscribers from reselling the privately placed securities within three years after delivery of such securities, unless the resale is carried out in any of the following ways or any other methods permitted by the SFB:

- The transferor and transferee are both local Qualified Financial Institutions and there are no securities of the same type that are concurrently traded on the TSE or Gre-Tai
- Following the first anniversary of the delivery of the privately placed securities, the subscriber may transfer its securities to the Qualified Financial Institutions or Qualified Natural Persons/ Legal Entities/Funds, subject to the restrictions prescribed by the competent authority concerning holding period and trading volume.

For transfer of common shares, the aggregate transfer amount of common shares in a 3-month period must not exceed the higher of the following: 0.5% of the total outstanding common shares of the company or 50% of the average daily trading volume of the company’s common shares on Gre-Tai for a period of 20 business days prior to the date of the transfer.
Securities Law Issues/SFB Regulations

The SFB promulgates regulations pursuant to the SEL that pertain to public companies (which have been approved by the SFB to publicly issue their shares) and listed companies on the TSE or the Gre-Tai.

The objective of the SFB regulations is to prevent the abuse of listing rules and the circumvention of initial public offering requirements. The regulations provide guidelines for mergers between listed companies as well as mergers between private companies and listed companies. Partly as a result of the liberalization of the relevant SFB regulations, there have been more M&A activities involving listed companies.

Regulation of Public Tender Offers

While acquisition of the shares of a TSE- or Gre-Tai-listed company through a securities exchange is feasible, large-scale acquisition of shares of a public company within a short period of time can, in practice, only be carried out through a public tender offer. The tender offeror may launch a tender offer to acquire up to 100% of the shares of a public company. In addition, under the SEL, any person who, whether acting independently or in conjunction with another person or persons, intends to acquire 20% or more of the total issued and outstanding shares of a public company within a period of 50 calendar days, must purchase the shares through a public tender offer.
Public tender offers to purchase the securities of a public company can bypass the TSE or Gre-Tai but they may be conducted only after the tender offer has been reported to the SFB and publicly announced. In relation to any competitive (second or subsequent) public tender offer for the same securities issued by the same public company, a report of public tender offer shall be filed with the SFB and a public announcement shall be made at least five trading days prior to the expiry date of the original public tender offer period.

Pursuant to Article 43-1 of the SEL, the SFB’s Regulations Governing Tender Offers for Purchase of the Securities of a Public Company (the “Tender Offer Regulations”) prescribe the circumstances under which a company can make a public tender offer. The Tender Offer Regulations provide that a tender offer must be conducted in accordance with the following requirements:

- Public Tender Offer means the purchase of securities from unspecified persons that bypasses the centralized securities exchange (TSE) or the over-the-counter (Gre-Tai) markets and instead uses public announcement, advertisement, radio broadcast, telecommunication, letter, telephone, presentation, explanatory declaration or other methods to make a public offer.

- The applicable securities under the Tender Offer Regulations include existing shares, entitlement certificates to subscribe for new shares, warrants, preferred shares attached with warrants, convertible corporate bonds, corporate bonds attached with warrants, depositary receipts and any other types of securities of a company that is approved by the SFB.

- Neither the person who makes a tender offer, (the tender offeror) nor his or her affiliate shall, from the application date of a public tender offer to the end of the tender offer, purchase shares of the public company either on the TSE or the Gre-Tai, or in any manner other than through the tender offer.

- The tender offeror must file a report with the SFB and publicly announce the intended tender offer before making such an offer to purchase shares of a public company, except where the sum of the securities proposed by the offeror and the existing securities owned by the offeror and its affiliates do not exceed 5% of the offeree’s issued voting shares, or where the offeror already holds 50% or more of the offeree’s issued voting shares. The report and documents must also be delivered to the public company whose shares are the target of the tender offer, and the public announcement should be posted on the Market Observatory Post System (“MOPS”), which is accessible through the Internet (http://newmops.tse.com.tw/).
• During the period of the tender offer, the tender offeror may not cancel the offer unless the offeror can prove that there is a material adverse change on the financial and business condition of the target company or the offeror is pronounced bankrupt, dead, incapacitated or in reorganization. The offeror has to obtain prior approval from the SFB for cancellation of the tender offer.

• During the period of the tender offer, the offeror cannot lower the public tender offer price, the proposed number of securities to be purchased through the public tender offer or shorten the public tender offer period.

• Any one of the following transactions is exempt from mandatory tender offer:
  - The transfer of shares of a public company among its affiliates as defined under the Tender Offer Regulations
  - The acquisition of shares of a public company in accordance with the public auction rules or the public bidding rules as promulgated by the TSE
  - The acquisition of shares of a public company in accordance with the public bidding rules as promulgated by Gre-Tai
  - The acquisition of shares of a public company held by its director, supervisor, manager or shareholder holding more than 10% of shares in accordance with Article 22-2 l (iii) of the SEL
  - The acquisition of shares of a public company in consideration of the shares issued by another company in accordance with Article 156VIII of the Company Law or Article 29 of the EML
  - Any other transaction as promulgated by FSC from time to time

• The public tender offer period shall be at least 10 calendar days but not more than 50 calendar days. After reporting to the SFB and making a public announcement with legitimate reasons for such extension, the tender offeror may extend the tender offer period up to 30 days. For example, a competing tender offer is a legitimate reason for the extension of the tender offer period.

• Prior to public announcement of satisfaction of the conditions of the public tender offer, the offeree may at any time revoke its sale offer in writing.

• After completion of a public tender offer in accordance with the foregoing rules, a tender offeror who has acquired more than 10% of the outstanding issued shares of a listed company is exempt from announcing the acquisition of such shares through the completed tender offer, which would otherwise be required under Article 43-1 of the SEL (see Announcements of the Share Activity of a Public Company below).
During the period from the decision to commence a public tender offer until the reporting and public announcement of the offer, any person who becomes aware of any information relating to that public tender offer due to his or her job duties or any other reasons shall keep such information in confidence (see Special Restrictions on Selling Shares of a Listed Company - Insider Trading below).

Before the commencement date of the public tender offer, the tender offeror, unless buying back its own shares under Article 28-2 of the SEL (which is subject to other requirements) must file a report with the SFB. Simultaneously, it must serve to the public company whose securities are being acquired ("Target"), the completed Public Tender Offer Report Form and the following documents:

- Public tender offer prospectus
- The mandate contract entered into between the tender offeror and the mandated tender offer agent pursuant to Article 15 of the Tender Offer Regulations
- The power of attorney to the tender offeror’s designated representative for litigious and non-litigious matters if the tender offeror does not maintain any domicile or business place in Taiwan
- Other documentation required by the SFB

(collectively, "Tender Offer Documents")

After the Target receives a copy of the Tender Offer Documents from the tender offeror, it must have the following items publicly announced, reported in writing to the SFB, and copied to the other relevant authorities governing securities-related matters, including the TSE, Gre-Tai or the Securities and Futures Investors Protection Center:

- The type and number of shares held by the Target’s directors, supervisors and any major shareholders holding more than 10% of the shares in the Target
- The recommendation made to the Target’s shareholders on the tender offer, which should state the names of any directors who have objected to the tender offer and their reasons for the objection
- Whether there have been any major changes in the Target’s financial conditions after the delivery of its latest financial statements and, if so, a description of the changes
- The type and number of shares of the Offeror or its affiliated enterprises (as the term is defined under Chapter 6-1 of the Company Law) held by the Target’s directors, supervisors and the major shareholders holding more than 10% of the shares in the Target
- Any other relevant material information
In addition, the Target must, immediately after receiving a copy of the Tender Offer Documents from the tender offeror, form a review committee to: (a) review the reasonableness and fairness of the terms of the tender offer; and (b) provide a recommendation to the shareholders of the Target.

The review committee must have at least three members. Where the Target has independent directors serving on its board, the independent directors must be the default committee members. However, where the Target does not have any independent directors or where the number of independent directors of the Target is insufficient to meet the minimum composition requirement of the review committee, the committee members may be selected by the Target’s board of directors. The board of directors must select the committee members in accordance with the relevant requirements (including eligibility criteria) and procedures relating to the appointment of an independent director of a public offering company.

The review committee’s decision must be supported by a simple majority of the committee members, and any reasons for and against the decision given by committee members should also be recorded.

Once the review committee is formed, it has a period of seven days to reach its decision and the Target should announce the decision of the review committee within the seven-day period.

The Target should inform, and cause the review committee to repeat the process above if the Target receives a copy of a new set of the Tender Offer Documents, and make the announcement within the seven-day period.

If the public tender offer requires approval by or effective registration with the FSC or any other competent government authority, the filing documents must be reviewed by an attorney, and a duly prepared legal opinion must also be furnished together with other filing documents.

Before the date on which the public tender offer begins, the tender offeror shall make public the completed Public Tender Report Form on the MOPS as well as announce the website where the public tender offer prospectus and related information can be accessed.

The tender offeror shall mandate a securities firm, bank or other institution approved by the SFB to be responsible for taking the offeree’s deposit of securities, the delivery of public tender offer prospectus, and the receipt and payment of the public tender offer funds or securities, etc.
The tender offeror shall, within two days after expiry of the public tender offer period, report to the SFB and publicly announce the following matters:

- The name or trade name, and domicile or location of the tender offeror
- The name of the public company whose securities are being acquired
- The types of securities acquired
- The public tender offer period
- If the tender offer purchase is conditioned upon the number of shares to be sold reaching the projected number of shares to be acquired, a description of whether such condition has been satisfied
- The number of the securities to be sold/bought and the actual number sold/bought
- The time, manner and place for payment of the purchase consideration
- The delivery time, manner and place for the transacted securities

Takeover Code

There is no special takeover code in Taiwan.

Special Restrictions on Buying or Selling Shares of a Listed Company - Insider Trading

Insider Trading Rules

Article 157-1 of the SEL provides that if the persons listed below obtain information that has a material effect on the price of shares (or other equity-type security) of a TSE- or Gre-Tai-listed company, they may not buy or sell shares of the company prior to public disclosure of such information or within 18 hours after such public disclosure:

- The directors, supervisors and managers of the company and the individual representatives who were designated by a company to assume the position of director or supervisor
- Shareholders who hold more than 10% of the total outstanding shares of the company
- Persons who obtain such information as a result of their profession or a controlling relationship with the company
Persons who have only lost any of the three above-listed statuses within the last six months (the four above-listed persons are collectively referred to as “Insiders” or “Tippers”)

Persons who obtain the information from any of the persons identified above (“Tippee”)

Civil Liability

A person who violates Article 157-1 of the SEL will be held liable to bona fide trading counterparties for damages in the amount of the difference between the buying and selling prices prior to the date of public disclosure and the average closing price for 10 business days after the disclosure. The court may also, upon the request of the bona fide trading counterparties, award treble damages if the violation is found to be material.

Criminal Liability

According to Article 171 of the SEL, a person who violates Article 157-1 of the SEL shall be subject to imprisonment for a term of no less than three years and not more than 10 years and, in addition, a fine ranging from TWD10 million to TWD200 million. Notwithstanding the above, if the profit gained from the violation of Article 157-1 of the SEL reaches TWD100 million or more, a prison sentence of not less than seven years shall be imposed, and in addition, a fine ranging from TWD25 million to TWD500 million may also be imposed.

Material Information

According to Article 157-1(5) of the SEL, information that may have a material effect on the price of securities shall mean information relating to the finance or business of the said listed company, the supply and demand of such securities on the market, tender offer of such securities that will have a material effect on their price or any other information that would have a material effect on the investment decision of a reasonably prudent investor (collectively referred to as “Material Information”). In order to provide a more detailed definition of Material Information, the SFB enacted the Regulations Governing the Scope of Material Information and the Means of its Public Disclosure in May 2006, which is amended from time to time and was last amended in December 2010.
Insider Trading and M&A

Information regarding a proposed merger or acquisition of a company will generally constitute Material Information. If the Insider of an acquiring company or a target company, or a Tippee obtains information as to the proposed merger or acquisition, and buys or sells shares of the target company based on such information prior to public disclosure of the same or within 18 hours after public disclosure, such person will be deemed as violating the insider trading rules.

Prosecutors may be very aggressive in investigating insider trading cases. For example, the chairman of a high-tech company was indicted for being involved in insider trading and the case drew a lot of attention since it was beyond the common understanding of insider trading. The acquiring company intended to acquire the assets of the target and the two companies initiated negotiations from August 2005. Both boards passed resolutions in favor of such transaction on 18 January 2006. The chairmen signed the relevant memorandum of understanding and held a media conference to announce such information on the same day. The prosecutor found that one manager of the acquiring company sent an email to the chairman in November 2005 stating that such transaction will in fact consummate after conducting the requisite due diligence. The prosecutor indicted the chairman of the acquiring company for violating Article 157-1 of the SEL since the chairman obtained Material Information from the manager in November 2005 and bought shares of the target company before such information was disclosed on 18 January 2006. Many lawyers criticized this indictment since the board of the acquiring company did not pass the resolution until 18 January 2006, and the two companies did not come to an agreement about the price of the shares under such transaction until December 2005. This case was brought to trial and the judgment may have a profound effect on future M&A transactions.

To avoid an insider trading investigation, when a proposed merger or acquisition is being negotiated or in progress, the Insider of the acquiring company or target company should avoid buying or selling shares of the target company and should not disclose such information of the proposed transaction to a third party, or create a Tippee.

Announcements of the Share Activity of a Public Company

Under Article 43-1 of the SEL, any person who, whether acting independently or in conjunction with another person or persons, acquires shares representing 10% or more of the outstanding issued shares of a public company, is required to report this transaction to the SFB within 10 days after the acquisition. Provided that the
shareholder maintains at least a 10% ownership in the outstanding issued shares of the company, the shareholder must also report to the SFB when he or she subsequently acquires an additional 1% or sells 1% of his or her shares within two days of such transaction. These requirements allow the management of the target company to learn of any outside attempts to acquire control of the company and to take certain precautions in response.

The “acquisition of shares in conjunction with other persons” refers to the acquisition of shares by a person through a contract, arrangement or other agreement. Additionally, any person who acquires shares through his or her spouse, minor children or nominee is required to include such shares in the calculation of shares owned by such person.

The following information must be disclosed within 10 days after the acquisition:

- The identity, name or corporate name, national identification card number or company uniform number, domicile address or business place of the investor and the joint investor(s); if the investor is a company, the name or corporate name, national identification card number or company uniform number, domicile address or business place of any shareholder who holds 5% or more of the outstanding shares of the investor or any person who directly or indirectly controls such shareholder
- Total number of shares held at the time of filing the report and its shareholding percentage based on total issued shares
- Method and date of acquisition
- Purpose of acquisition
- Breakdown of sources of capital
- Total number of shares expected to be acquired within one year
- Plan of exercising any of the following rights pertaining to shares, and if yes, specify any:
  - plan to convene a special shareholders’ meeting individually or jointly with others
  - plan to run for election of directors or supervisor(s)
  - plan to dispose of assets or change the financial or business plan of the company in which shares are acquired
  - Other matters which are required to be reported to the SFB
Compulsory Acquisition of a Minority Shareholding

Article 186 of the Company Law provides that when a company enters into, amends or terminates an agreement to lease the entire business, delegates management or jointly manages the business with a third party, disposes of all or the essential parts of its business or assets, or purchases all of the business or assets of another company and the said transaction has a material effect on the operation of the company, the dissenting shareholders have the right to request the company to purchase their shares.

Article 12 of the EML provides for similar minority shareholder appraisal rights. If a shareholder objects for the record to a merger, a spinoff, 100% share swap or an acquisition under the EML prior to or during the shareholders’ meeting held to approve such transaction, the shareholder may request that the company purchase his or her shares at the current fair value (see below) and waive his or her right to vote in the resolution. In the event of a short form merger, the shareholder of the subsidiary company may request that the company purchase his or her shares at the current fair value (see below) if such shareholder of the subsidiary company has expressed his/her objection in writing within a term specified in the notice announced by the Board of Directors of the subsidiary company.

In accordance with a ruling provided by the MOEA, fair price means the market price, the share price of a company in the same or similar industry or the price agreed by the parties and duly documented in an instrument in writing.

Company Law Notification Requirements

The Company Law requires certain notifications and announcements to be made in connection with share purchase transactions, even where the target company is not a public or listed company. Article 369-8 of the Company Law provides that where one company acquires more than one-third of the voting stock or capital of another company, the acquiring company is required to notify the target company in writing within one month following such transaction.

For the purpose of calculating the number of stock or the amount of capital being held by the acquiring company hereunder, the following stock or capital of the target company shall also be included in the calculation:

- The stock or capital held by any subordinate company of the acquiring company
- The stock or capital held by a third party nominee for the acquiring company
• The stock or capital held by a third party nominee for any subordinate company of the investing company

Subsequent to the aforementioned notification, the acquiring company that has obtained more than one-third of the voting stock or capital of the target company should also notify the target company in writing within five days of the occurrence of any of the following events:

• The acquiring company’s ownership of the voting shares or capital of the target company falls below one-third of the total voting shares or capital of the target company;

• The acquiring company obtains more than one-half of the voting shares or capital of the target company; or

• The acquiring company’s ownership of the voting shares or capital of the target company as described in the preceding paragraph falls below one-half of the voting shares or capital of the target company.

The target company is then required to make a public announcement regarding the notified event within five days of receipt of the notification. The announcement should specify the name of the acquiring company, the percentage of shares owned and the amount of capital contributions made. If the acquiring company or target company fails to comply with the above notification provisions, the responsible person of the non-compliant company may be subject to fines ranging from TWD6,000 to TWD30,000 and will be required to comply within a specified period. If the company fails to comply within the specified time period, the competent authority may fix another time limit for the company to comply and may impose successive fines ranging from TWD9,000 to TWD60,000 for each failure to comply.

Creditor Notification Requirements

Notifications to creditors shall be made in accordance with the Company Law, the EML or the Financial Institutions Mergers Law ("FIML"). The notification requirements and the effect of such notification vary depending on the type of M&A activities adopted by the parties.

For example, in relation to notification to creditors under a merger or a spinoff transaction, the company shall make public announcement and notify each of its creditors of such transaction, and the creditors shall be given a period of no less than 30 days to object to such transaction. If a company has not given notice or made a public announcement, fails to satisfy the claim of a creditor who has
raised an objection to the transaction, fails to furnish an appropriate security, fails
to create any trust exclusively for the satisfaction of creditors’ claims, or fails to
certify that such transaction is without prejudice to the rights of the creditors, the
company shall not assert the transaction as a defense against such creditor in
any legal actions.

Independent Expert Opinion Requirements in Connection
with M&A Under the EML

Article 6 of the EML requires a public company to seek an independent expert
to provide expert opinion on the reasonableness of the share-swap ratio and
amount of cash or assets to be distributed to the shareholders before the board of
directors can pass a resolution in favor of any merger or acquisition. This opinion
should be reported to the board of directors and at the shareholders’ meeting.
According to a ruling issued by the MOEA, an accountant, a lawyer or a securities
underwriter is qualified as an independent expert.

Specific Industry Regulation

Financial Institutions Merger Law

In order to encourage merger of financial institutions, the FIML was promulgated
in December 2000. Favorable tax incentives include the following:

- Stamp duties and deed tax arising from the merger are exempted.
- Land value increment tax is deferred upon merger until the subject land is
  further transferred after merger.
- Goodwill arising from the merger can be amortized within five years.
- Merger expenses can be amortized within 10 years.
- Losses on the sale of non-performing loans because of merger can be
  recognized within 15 years.
- The five-year loss carry-forward privilege of the merging entities can be
  retained for use by the surviving company or the new entity created by the
  merger for deduction against the company’s net income within five years of
  the occurrence of such loss.
Financial Holding Company Act

Merger and acquisition transactions in connection with the financial holding company shall be subject to several unique treatments under the Financial Holding Company Act (“FHCA”), promulgated in July 2001 and amended on 1 January 2009. The FHCA contains certain key provisions, as set out below.

- A mechanism is provided for the asset-liability transfers and share swaps in order to facilitate the conversion of banks, insurance companies and securities firms into financial holding companies or subsidiaries thereof.

- Tax and non-tax incentives are made available, such as tax exemptions and reductions in fees and costs associated with the setting-up of a financial holding company (“FHC”).

- Banks, insurance companies and securities firms that are listed on the TSE and Gre-Tai and seek to convert into an FHC must transfer 100% of their shares to the FHC and set an effective date for the listing of the FHC on the TSE or Gre-Tai. This requirement was instituted in order to simplify and make more transparent the equity structure of such FHCs while still protecting the interests of the shareholders.

- With the prior approval of the competent authority, an FHC and its subsidiaries may cross-sell through exchange of information and joint use of business facilities and locations in order to enhance synergies within the financial group, under the preconditions that the interests of FHC clients will not be harmed, and the relevant entity must obtain prior consent of its clients for the exchange of information among the FHC and its subsidiaries.

- The FHC and its 100%-owned subsidiaries may prepare consolidated financial statements and joint tax returns.

- Foreign FHCs may submit the application form as well as the required documents to the Taiwan government for recognition and approval. Foreign FHCs recognized and approved by the Taiwan government will enjoy the same rights as those granted to local FHCs.

- An FHC’s business scope generally includes management of those companies in which it invests; however, if the FHC invests in a venture capital company, a responsible person or employee of the FHC must not manage the target companies in which said venture capital company invests.

- Investments of the FHC are generally restricted to the financial sector, unless special approval from the competent authority has been obtained; however,
even with approval to invest in a corporate entity of other sectors, the FHC and its representative must not be the director or supervisor of such entity, or designate a person to be the manager of such entity, unless it is otherwise approved by the competent authority.

- Subsidiaries of the FHC may not invest in or hold shares of the FHC.

As provided in the FHCA, financial groups may create an FHC under one of two mechanisms. One mechanism is the transfer of assets and liabilities, in which case the entity that plans to be converted into an FHC transfers major assets and liabilities to a new or existing company. The net value of transferred assets/liabilities will be deemed the equity investment in this new or existing company. The transferor will subsequently convert into the FHC and the transferee will become a subsidiary of the FHC. A key advantage of this mechanism is that the transferor retains its listing status if it was listed prior to the transfer.

The other mechanism by which financial groups may create an FHC under the FHCA is the swapping of shares. Under this mechanism, shareholders of a company seeking conversion into an FHC will, in the shareholders’ meeting, approve the swap of all the company shares in exchange for new shares issued by a new or existing company to be designated as the FHC.

Shareholders of the company thus become shareholders of the FHC, and the FHC becomes the sole shareholder of the converted company. The swapping of shares is the most convenient way to set up an FHC. However, the new FHC has to apply for a listing on a securities exchange, which means that the competent authorities will review whether the new FHC meets all the requirements for listing.

**Purchase of a Company under Reorganization**

The Taiwan Company Law provides for court-supervised restructuring of potentially viable but insolvent companies. Court-supervised corporate reorganization is intended to assist potentially viable yet insolvent companies to generate sufficient cash flow to meet their debts. A series of regulations and restrictions apply to the purchase of shares or assets from a company under reorganization. The key concepts relating to reorganization are set out below.

- Reorganization is applicable only to companies of which the stocks or corporate bonds are publicly issued and outstanding.

- Reorganization is commenced by filing a petition with the District Court. After receipt of the petition for reorganization, the District Court may issue an Interim Order to freeze the company’s properties from being disposed; limit
the company’s operations, performance of obligations and other assertions of claims against the company; suspend proceedings in relation to bankruptcy, composition or compulsory execution against the company; prohibit the transfer of the registered share certificates of the company; and/or investigate and determine the responsible person’s liability for damage to the company and freeze his or her personal properties. The Interim Order shall not exceed a period of 180 days and will be void once the petition for reorganization is rejected by the District Court.

- The District Court will issue an order authorizing the reorganization if it determines that the reorganization is necessary.

- During the reorganization:
  - all bankruptcy proceedings and compulsory execution proceedings as well as other lawsuits arising out of disputes regarding properties will be automatically suspended;
  - reorganization supervisors and managers will be appointed;
  - the creditors are required to submit their proof of claims;
  - interested parties’ committees will be formed; and
  - a feasible reorganization plan agreed by the interested parties’ committees shall be approved by the court before its implementation.

- The reorganization manager will manage the company’s business and dispose of the company’s properties under the supervision of the reorganization supervisor and in accordance with the reorganization plan.
Preliminary Agreement - Memorandum of Understanding/Letter of Intent

Under Taiwan law, a memorandum of understanding or letter of intent may be made either binding or non-binding, depending on the substance of the provisions. It is prudent to specify the document’s legal effect in the document itself.

Due Diligence

Before conducting any M&A, due diligence of the target company should be conducted. However, some small private business owners may not be familiar with the concept and process involved in the due diligence exercise.

Documentation and Agreements

In addition to the typical M&A transaction documents, the following documentation are required under the EML:

- For statutory mergers, a merger agreement must be presented to the shareholders at the shareholders’ meeting.
- For statutory 100% share swaps, a share-swap agreement must be presented to the shareholders at the shareholders’ meeting.
- For statutory spinoffs, a spinoff plan must be presented to the shareholders at the shareholders’ meeting.
This guide sets out the general landscape for M&A in Taiwan, from both the legal and the practical perspectives. Share purchases and asset purchases are common in Taiwan. The structure of the transactions will determine the consequences with respect to taxation, statutory approvals, third-party consents and employment. The EML provides a number of favorable tax incentives for certain types of M&A transactions such as traditional asset purchases that were not previously available under either the Company Law or the Income Tax Law. This now allows investors more choice as to which structure to use in an M&A transaction.

Where an M&A transaction involves a public company or a listed company, there are additional restrictions and compliance with Taiwan securities legislation is required. For cross-border M&A, there are foreign investment restrictions and foreign exchange rules requiring compliance.

Finally, the most recent significant development in general inbound investments is the Taiwan government’s relaxation and amendments of the laws and regulations relating to investments by China (PRC) into Taiwan. This area has been gradually opened up and has significantly increased PRC investments.
### Negative List for Investment by Overseas Chinese and Foreign Nationals

#### Prohibited Industries

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<thead>
<tr>
<th>Group Code No.</th>
<th>Scope of Industry</th>
<th>Sub-item of Industry</th>
<th>Item</th>
<th>Competent Authorities</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>02</td>
<td>Forestry</td>
<td></td>
<td></td>
<td>Council of Agriculture</td>
<td>Overseas Chinese are not prohibited</td>
</tr>
<tr>
<td>18</td>
<td>Manufacture of Chemical Material</td>
<td>Manufacture of Basic Chemical Material</td>
<td>Manufacturing of nitroglycerine used in gunpowder/ explosive pillars involving public safety (for military use)</td>
<td>Ministry of National Defense</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Sodium-chloride factories operating with mercuric electrolyzers</td>
<td>Ministry of Economic Affairs</td>
<td>National Treatment</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>A category of chemical products in accordance with the prohibition of chemical weapons of U.N.</td>
<td>Ministry of Economic Affairs, Ministry of National Defense</td>
<td>National Treatment</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>CFC, Halon, methylchloroform, carbon tetrachloride</td>
<td>Ministry of Economic Affairs</td>
<td>National Treatment</td>
</tr>
<tr>
<td>Group Code No.</td>
<td>Scope of Industry</td>
<td>Sub-item of Industry</td>
<td>Item</td>
<td>Competent Authorities</td>
<td>Remarks</td>
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<td>19</td>
<td>Manufacture of Chemical Products</td>
<td>Manufacture of Other Chemical Products</td>
<td>Manufacture of toxic chemicals (which are prohibited pursuant to “Toxic Chemicals Control Act”)</td>
<td>Environmental Protection Administration</td>
<td>National Treatment</td>
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<td>Gun powder fuse, agents of fire and fulminating mercury</td>
<td>Ministry of National Defense</td>
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<td></td>
<td>Manufacture of Pesticides and Environmental Agents</td>
<td>Manufacturing of environmental agents prohibited pursuant to relevant laws</td>
<td>Environmental Protection Administration</td>
<td>National Treatment</td>
<td></td>
</tr>
<tr>
<td>24</td>
<td>Manufacture of Basic Metal</td>
<td>Manufacture of Other Basic Metal Not Elsewhere Classified</td>
<td>Cadmium smelting</td>
<td>Ministry of Economic Affairs</td>
<td>National Treatment</td>
</tr>
<tr>
<td>29</td>
<td>Manufacture of Machinery and Equipment</td>
<td>Manufacture of Other General - Purpose Machinery</td>
<td>Firearms, weapon manufacturing, arms repair, ammunition and fire-control (for military use, exclusive of military aircraft)</td>
<td>Ministry of National Defense, Ministry of the Interior</td>
<td></td>
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<tr>
<td>49</td>
<td>Land Transportation</td>
<td>Motor Bus Transportation</td>
<td>Passenger bus services (including city passenger bus services and highway passenger services)</td>
<td>Ministry of Transportation and Communications</td>
<td>Overseas Chinese are not prohibited</td>
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<td>Taxi Transportation</td>
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<td>Other Bus Transportation</td>
<td>Tour bus services</td>
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<td>54</td>
<td>Postal and Courier Activities</td>
<td>Postal Activities</td>
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<td>Ministry of Transportation and Communications</td>
<td>National Treatment</td>
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<tr>
<td>Group Code No.</td>
<td>Scope of Industry</td>
<td>Sub-item of Industry</td>
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<tr>
<td>60</td>
<td>Programming and Broadcasting Activities</td>
<td>Radio Broadcasting</td>
<td>Radio broadcasting; Radio television industry</td>
<td>National Communications Commission</td>
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<td></td>
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<td>Television Broadcasting</td>
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<td></td>
<td>Cable and Other Subscription Programming</td>
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<tr>
<td>64</td>
<td>Financial Intermediation</td>
<td>Postal Saving and Remittance Services</td>
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<td>Ministry of Transportation and Communications, Financial Supervisory Commission, Executive Yuan</td>
<td>National Treatment</td>
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<tr>
<td>69</td>
<td>Legal and Accounting Activities</td>
<td>Other Legal Activities</td>
<td>Public notary services</td>
<td>Judicial Yuan</td>
<td>Overseas Chinese are not prohibited</td>
</tr>
<tr>
<td>93</td>
<td>Sorts Activities and Amusement and Recreation</td>
<td>Special Amusement Activities</td>
<td></td>
<td>Ministry of Economic Affairs</td>
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</tbody>
</table>
### Negative List for Investment by Overseas Chinese and Foreign Nationals

#### Restricted Industries

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<thead>
<tr>
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<th>Scope of Industry</th>
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<th>Item</th>
<th>Competent Authorities</th>
<th>Remarks</th>
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</thead>
<tbody>
<tr>
<td>01</td>
<td>Agriculture and Animal Husbandry</td>
<td>Growing of Rice</td>
<td></td>
<td>Council of Agriculture</td>
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<td></td>
<td></td>
<td>Growing of Cereals (except Rice)</td>
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<td>Growing of Special Crops</td>
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<td>Growing of Vegetables</td>
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<td>Growing of Fruits</td>
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<td>Growing of Mushrooms</td>
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<td>Growing of Flowers</td>
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<td>Growing of Other Crops</td>
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<td></td>
<td></td>
<td>Raising of Cattle</td>
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<td>Raising of Swine/Pigs</td>
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<td>Raising of Chickens</td>
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<td>Raising of Ducks</td>
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<td></td>
<td></td>
<td>Other Animal Husbandry</td>
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</tbody>
</table>

| 03             | Fishing and Aquaculture         |                          |                    | Council of Agriculture|                    |
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<th>Remarks</th>
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<tbody>
<tr>
<td>10</td>
<td>Manufacture of Tobacco Products</td>
<td></td>
<td>Manufacture of Tobacco Products</td>
<td>Ministry of Finance</td>
<td>National Treatment</td>
</tr>
<tr>
<td>18</td>
<td>Manufacture of Basic Chemical Materials</td>
<td>Manufacture of Basic Chemical Materials</td>
<td>Manufacture of nitroglycerine not used in gunpowder/explosive pillars involving public safety (for military use)</td>
<td>Ministry of National Defense</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>Manufacture of Chemical Products</td>
<td>Manufacture of Other Chemical Products</td>
<td>Manufacture of toxic chemicals subject to approval pursuant to &quot;Toxic Chemicals Control Act&quot;</td>
<td>Environmental Protection Administration</td>
<td>National Treatment</td>
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<tr>
<td></td>
<td></td>
<td>Manufacture of Pesticides and Environmental Agents</td>
<td>Manufacture of Environmental Agents subject to approval pursuant to relevant laws</td>
<td>Environmental Protection Administration</td>
<td>National Treatment</td>
</tr>
<tr>
<td>25</td>
<td>Manufacture of Fabricated Metal Products</td>
<td>Manufacture of Metal Hand tools</td>
<td>Swords manufacturing subject to approval pursuant to &quot;Statute for Gun, Cannon and Swords Control Articles&quot;</td>
<td>Ministry of the Interior</td>
<td>National Treatment</td>
</tr>
<tr>
<td>27</td>
<td>Manufacture of Computers, Electronic and Optical Products Manufacturing</td>
<td></td>
<td>Military instrument and equipment</td>
<td>Ministry of National Defense</td>
<td></td>
</tr>
</tbody>
</table>

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Guide to Mergers and Acquisitions

Baker & McKenzie
## Negative List for Investment by Overseas Chinese and Foreign Nationals

### Restricted Industries

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<thead>
<tr>
<th>Group Code No.</th>
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<th>Item</th>
<th>Competent Authorities</th>
<th>Remarks</th>
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</thead>
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<tr>
<td>31</td>
<td>Manufacture of Other Transport Equipment and Parts</td>
<td>Manufacture of Other Transport Equipment and Parts Not Elsewhere Classified</td>
<td>Manufacture, Repair and Assemble of Military Aircraft</td>
<td>Ministry of National Defense, Ministry of Economic Affairs</td>
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</tr>
<tr>
<td>35</td>
<td>Electricity and Gas Supply</td>
<td>Electricity Supply</td>
<td>Electric power supply and power distribution</td>
<td>Ministry of Economic Affairs</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Gas Supply</td>
<td>Piped</td>
<td>Ministry of Economic Affairs</td>
<td></td>
</tr>
<tr>
<td>49</td>
<td>Land Transportation</td>
<td>Truck Freight Transportation</td>
<td>Trucking, fixed-route trucking and container trucking carrier</td>
<td>Ministry of Transportation and Communications</td>
<td></td>
</tr>
<tr>
<td>50</td>
<td>Water Transportation</td>
<td>Ocean Transportation</td>
<td>Transport by ship and ship leasing service</td>
<td>Ministry of Transportation and Communications</td>
<td>Overseas Chinese are not prohibited</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Inland and Lake Transportation</td>
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<tr>
<td>51</td>
<td>Air Transportation</td>
<td>Air Transportation</td>
<td></td>
<td>Ministry of Transportation and Communications</td>
<td>Overseas Chinese are not prohibited</td>
</tr>
<tr>
<td>52</td>
<td>Supporting Activities for Transporta-</td>
<td>Services Activities Incidental to Air Transportation</td>
<td>Airport ground services, and air catering services</td>
<td>Ministry of Transportation and Communications</td>
<td>1. Overseas Chinese are not prohibited 2. Except and otherwise provided in relevant treaties or agreements.</td>
</tr>
</tbody>
</table>

1. Overseas Chinese are not prohibited
2. Except and otherwise provided in relevant treaties or agreements.
### Negative List for Investment by Overseas Chinese and Foreign Nationals

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<th>Remarks</th>
</tr>
</thead>
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<tr>
<td>60</td>
<td>Broadcasting and Program-ming</td>
<td>Radio Broadcasting</td>
<td>Harbor and the relevant services (tally and stevedore services)</td>
<td>National Treatment</td>
<td>National Treatment</td>
</tr>
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<td></td>
<td></td>
<td>Television Broadcasting</td>
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<td></td>
<td></td>
<td>Cable and Other Subscription Programming</td>
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### Negative List for Investment by Overseas Chinese and Foreign Nationals

#### Restricted Industries

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<tr>
<th>Group Code No.</th>
<th>Scope of Industry</th>
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<td>Scrivener Activities</td>
<td>Land registration services</td>
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<td></td>
<td>Accounting, Bookkeeping and Auditing Activities; Tax Consultancy</td>
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<td>71</td>
<td>Architectural and Engineering Services; Technical Testing and Analysis Services</td>
<td>Architectural Services</td>
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<td>Rental and Leasing</td>
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APPENDIX B

Approval Flow Chart for Investment Application by Overseas Chinese or Foreign

1. Application submitted
2. Application received by the IC
3. Application submitted to the responsible officer of the IC
4. Primary review by the responsible officer of the IC
5. Application approved by the Director of 1st Division of IC
6. Application approved by the Executive Secretary of the IC
7. Issuance of FIA

Timeframes:
- 0.5 Day
- 2 Days
- 3-14 Days
- 0.5 Day
- 1 Day
- 4 Days
- 7-21 Days

Baker & McKenzie
THAILAND
DISCLAIMER

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This may qualify as “Attorney Advertising” requiring notice in some jurisdictions. Prior results do not guarantee a similar outcome.
Thailand has different laws and regulations governing different merger and acquisition ("M&A") activities. For M&A activities related to a private company, the rules and procedures for the merger and acquisition are mainly governed by the Civil and Commercial Code of Thailand ("CCC"), while those activities for a public company will mainly be governed by the Securities and Exchange Act B.E. 2535 (1992) ("SEC Act") as well as the Public Limited Company Act B.E. 2535 (1992) (the "PLCA"). For a public company whose shares are traded on the Stock Exchange of Thailand ("SET"), the rules and regulations of the SET, the Securities Exchange Commission ("SEC") and the Capital Market Supervisory Board ("CMSB") must also be taken into consideration when M&A activities are carried out.
There are three main forms of M&A in Thailand (strictly speaking, the concept of “merger” is not recognized in Thai law; there is instead the concept of “amalgamation” but for the purposes of this outline we use the term merger in the generally understood sense). M&A of two or more companies may be in the form of: an amalgamation or a consolidation; an acquisition of shares in a target company; or an acquisition of assets of the target company. In addition to these three main forms, there are also some situations where, for commercial reasons, a combination of acquisitions is necessary. Generally, the transaction begins with a share acquisition to acquire an entire entity, and is then followed by an amalgamation or asset acquisition to dispose of all or a part of the assets to the acquiring entity.

The less common form of M&A is the consolidation of two or more companies into a new company due to the tax disadvantage as explained later in this guide. The consideration for shares or assets in the target company may be in the form of cash, shares in the acquiring companies, other securities or a combination of the above. Currently, the Revenue Department has granted a tax exemption for an asset acquisition transaction. The company will benefit from this exemption if it acquires the assets of a target company. The details of such exemption are explained later in this guide.
Amalgamation/Mergers of Companies

Under the CCC, which governs the mergers of private companies, and under the PLCA, which governs the mergers of public companies, once two or more companies are merged, the merged company will become a new company and the merging companies will lose their juristic status. The new company will be entitled to all assets, liabilities, rights, duties and responsibilities of the merging companies.

A major drawback of amalgamation is that the new corporation loses the opportunity to treat the net loss of the original corporation as an expense when computing net profit for tax calculation purposes. Furthermore, the transaction may involve several complicated, time-consuming legal procedures.

Procedure for Mergers Involving Private Companies

Prior to the recent amendments to the CCC, the mergers of private companies required the special resolutions of the shareholders of the merging companies, where two successive general meetings of shareholders needed to be held, and at the first and second meetings, three-quarters and two-thirds of the votes of all the shareholders were required, respectively. The merging companies were also required to publish such merger transactions in the newspaper and send notices to all of their creditors allowing a period of at least six months for creditors to object to the merger. The whole process under the former CCC took at least eight months to complete. As such, mergers under this method were unpopular.

However, with the amendments to the CCC by virtue of the Act to Amend the Civil and Commercial Code (No. 18) B.E. 2551 (2008), which came into force and effect on 1 July 2008, a special resolution of shareholders in private limited companies currently requires only one shareholders’ meeting, resolving with an affirmative vote of at least three-quarters of the votes of all shareholders, rather than two successive shareholders’ meetings as previously applicable. In order to pass a special resolution for the merger of private companies, only one general meeting of shareholders is required with at least three-quarters of the votes of shareholders attending the meeting and entitled to vote.

In addition, the amended CCC allows for a shorter period in which a private limited company is required to announce its merger. The amended CCC requires the publication of the announcement of the merger in local newspapers once, rather than seven times as previously applicable. Moreover, the creditors’
objection period is substantially reduced from six months to 60 days. With such developments in the CCC, the process will take about three to four months to complete - less than a half the time under the previous CCC.

Note that if a company’s articles of association specify certain requirements in line with the previously applicable CCC that are more stringent than the amended CCC, the company must comply with its articles of association, unless the articles of association are changed to meet the latest CCC.

Procedure for Mergers Involving Public Companies

The merger procedures for public companies are substantially similar to those of private companies. Both private limited companies and public limited companies require only one general meeting of shareholders with three-quarters of the shareholders attending the meeting and voting in favor of the merger proposal. Although the creditors have the right to object to the transaction, the maximum objection period in case of public limited companies is two months, while the maximum objection period in case of private limited companies is slightly different, i.e., 60 days.

With regard to public company shareholders and the rights of dissenters, if there is any shareholder who objects to the proposed merger (a "Dissenter"), the merging company is required to arrange for the purchase of shares held by the Dissenter at the price last traded on the exchanges prior to the date of the shareholders’ resolution or, if there is no such trading price, the price determined by an independent appraiser. A Dissenter who refuses to sell his or her shares within 14 days of receiving the purchase offer shall be deemed to agree with the merger.

Assets Acquisition

Even though there were the recent amendments to the CCC, merger procedures are still considered complex and relatively time-consuming. Therefore, other forms of M&A transactions, such as the acquisition of shares or assets in the target company (or companies) are usually more popular in Thailand than merger procedures. In an asset acquisition, both the acquiring and the acquired entities survive. The acquired entity merely divests its assets or business(es) and transfers them to the acquiring entity. After completion of the transaction, whether or not the acquired company is dissolved or is maintained to undertake another business, is a separate point of consideration.
Procedures for Acquisition of Assets of a Private Company

There is no specific clause in the CCC that requires a private company or its board of directors to obtain approval from the shareholders prior to any sale or transfer of all, substantially all or a major proportion of the assets of the company. As a result, there are two schools of thought on this issue. The first takes the view that since there is no specific legal requirement, no shareholders’ approval needs to be obtained. However, the second school of thought argues that since the acquisition is likely to have a significant impact on the interests of the shareholders, approval must be obtained from the shareholders prior to the transaction.

Procedures for Acquisition of Assets of an Unlisted Public Company

Unlike the CCC, the PLCA has a specific provision dealing with the sale or transfer of all or a major part of the assets of a public company. Section 107 of the PLCA clearly specifies that the sale or transfer of all or a substantial portion of the business of a public company to another person shall require a vote of not less than three-quarters of the total number of votes of shareholders who attend the meeting and have the right to vote.

Special Note on the Acquisition of Assets

There are some assets that are not transferable, including some governmental licenses, litigation claims pending in courts and land with a restriction of transfer. Therefore, special methods may be created on a case-by-case basis to overcome this obstacle.

Assets Disposition Rules: Additional Requirements for a Listed Public Company

In addition to the PLCA, a listed public company is also subject to the SEC Act and its amendments, which authorize the Capital Market Supervisory Board (“CMSB”) to promulgate any regulation and/or notification pertaining to the acquisition and disposition of assets by a listed company. The CMSB has promulgated a notification pertaining to the asset disposition rules (the “CMSB Notification”), which provides that every listed company is required to comply with the requirements on the assets disposition rules as prescribed in the notification stipulated by the SET when acquiring or disposing of its own assets or its subsidiary’s assets. A listed public company is required to report any incident
that affects or is likely to affect the rights and interests of the securities holders of a listed public company or influence investment decisions by the general public, particularly the manner in which the assets of the listed company or its subsidiary are acquired or disposed of. Therefore, several requirements under the CMSB Notification and SET’s notification (collectively referred to as the “Applicable Notifications”) are imposed on a listed public company wishing to acquire or dispose of its assets or its subsidiary’s assets, depending upon the importance of the transaction contemplated.

Nonetheless, due to the complex nature of the calculation method for determining the size or value of a contemplated transaction under the Applicable Notifications, consulting an accountant or financial or legal adviser is strongly recommended. Furthermore, the Applicable Notifications also include a number of other requirements, depending on the size of the disposed assets.

In addition to the requirements under the Applicable Notifications, a listed company is required to submit a report to the Office of the Securities and Exchange Commission (Office of the SEC) with a copy sent to the SET disclosing its decision to enter into an acquisition or disposition of assets after making the decision to enter into such transaction. A “decision to enter into a transaction” means entering into or a proposal to enter into any contract, negotiation, agreement or understanding, regardless of whether direct or indirect, in order to cause an acquisition or disposition of assets and/or rights to acquire or dispose of the assets.

Shares Acquisition

A share acquisition is a transaction whereby a potential acquirer seeks to buy a majority share in the acquired company (or effect a takeover). In this case, both the acquiring and the acquired entities survive but the acquired entity becomes a subsidiary of the acquiring entity.

Procedures for Acquisition of Shares of a Private Company

Acquisition of shares in a private company is quite simple. A transfer of shares to an acquirer is valid only if made in writing and signed by the transferor and the transferee whose signatures are certified by at least one witness. The number of shares to be transferred must also be stated in the share transfer instrument. Such transfer is ineffective against the company and third persons until the share transfer and the name and address of the transferee are recorded in the share register book of the company.
If the shares in question are to be newly issued shares, the target company must increase its capital and issue the new shares to the acquiring company. However, under the CCC, any newly issued shares can be allocated only to existing shareholders in proportion to their shareholdings; this is generally referred to as “preemptive rights.”

Therefore, in practice, the acquiring company will usually acquire at least one share in the target company from the existing shareholders, so that it becomes a shareholder of the target company prior to the increase of capital. Upon the capital increase and the shares’ issuance, the existing shareholders will waive their preemptive rights and the acquiring company will then subscribe for that portion of shares.

Although it is not legally required, it is normally recommend that the company prepare and submit to the Ministry of Commerce a new list of shareholders showing the transferee as the holder of the shares. The original of the share transfer document is subject to stamp duty at the rate of 0.1% of the sale price or the paid-up value of the shares, whichever is higher, while any duplicate is subject to the stamp duty at the fixed rate of THB5.

Procedures for Acquisition of Shares of a Public Company

Under the PLCA, a transfer of shares to an acquirer shall be valid upon the transferor’s endorsement of the share certificate by stating the name of the transferee and having it signed by both the transferor and the transferee and upon delivery of the share certificate to the transferee. The transfer of shares will be effective against the company upon the company having received a request to register the transfer of the shares but it may be effective against a third party only after the company has registered the transfer of the shares in its share register book.

As for acquisition of shares of a listed public company, additional regulatory requirements need to be meticulously considered. These include the regulations on the tender offer requirements (explained below); the assumption of liabilities, including those under the labor law; and regulations on shareholding limitations, which may be imposed on some types of regulated acquiring entities.
Foreign Investment Restrictions

In M&A activities in Thailand, careful consideration of the following laws should be made by foreign investors.

Foreign Business Act B.E. 2542 (1999)

The Foreign Business Act B.E. 2542 (1999) ("FBA") came into force on 3 March 2000. It replaced the Alien Business Law, issued in 1972. The purpose of the FBA is to prohibit or restrict foreigners from participating in specified business activities in Thailand and requires that licenses be obtained prior to engaging in certain businesses. However, a foreigner may wholly own a business in Thailand, unless the specific activity of that business is restricted under the FBA or is otherwise prohibited by another law.

The FBA defines “aliens” or “foreigners” as natural persons or juristic (legal) entities who do not possess Thai nationality. Companies are considered “foreign” for these purposes if 50% or more of their share capital belongs to foreign individuals or juristic entities.

The prohibited or restricted businesses under the FBA are categorized in three schedules (see Appendix A). Those activities contained in Schedule One are businesses that foreigners are not permitted to undertake for special reasons and there is no basis for licensing foreigners in these areas.
Schedule Two consists of businesses considered to concern national security or safety; or that have an impact on Thai art and culture, customs, native manufacture/handicrafts; or an impact on natural resources or the environment. Foreigners may engage in Schedule Two businesses only with permission from the Minister of Commerce, which in turn can only be issued pursuant to a resolution of the Cabinet.

In addition, even if licensed, such a foreign entity must include Thai nationals, or juristic persons that are not foreigners under the FBA holding not less than 40% of the capital of that foreign legal entity. Also, at least two-fifths of the directors must be Thai. However, the Commerce Minister, by and with resolution of the Cabinet may, in certain cases, reduce the required Thai shareholding percentage but under no circumstance can it be reduced to less than 25%.

Schedule Three comprises businesses where it is considered that Thais are not yet prepared to compete with foreigners. Foreigners may engage in Schedule Three businesses only with the permission of the Director-General of the Department of Business Development, the Ministry of Commerce, by and with approval of the Foreign Business Board. If a foreign enterprise receives this permission, the foreign entity can be 100% foreign-owned and there is no requirement for a minimum number of Thai directors.

The Foreign Business Board must review the businesses listed in the Schedule at least once a year and propose any necessary changes to the Ministry of Commerce.

**Treaty of Amity**

Many of the restrictions imposed by the FBA do not apply to Americans since Thailand and the US have entered into the Treaty of Amity and Economic Relations 1996 (the “Treaty”). Among the treaties to which Thailand is a signatory, the Treaty is by far the one that grants the most exemptions to the FBA. The Treaty allows US nationals and companies incorporated in the US or Thailand that are majority owned and controlled by US nationals, to largely conduct business in Thailand as would a Thai national. In cases of US companies incorporated in the US, they typically do business via their branch or representative offices in Thailand. In some other cases, they would take other forms of business entities such as incorporating an American majority owned company or acquiring majority shares in an existing company in Thailand. However, the Treaty still prohibits an American (either an individual or an entity) from undertaking any of six restricted businesses: transportation, carriage, fiduciary functions, banking involving depository functions, the exploitation of land or natural resources, and domestic trade in indigenous agricultural products.
Before undertaking a restricted business as specified in the FBA (other than the said six restricted businesses), a US individual or entity must apply to the Director-General of the Department of Business Development, the Ministry of Commerce, for a foreign business certificate acknowledging the carrying on of such specified restricted business.

There is some uncertainty surrounding the continued availability of exemptions for US nationals under the Treaty due to Thailand’s WTO obligations, since the WTO derogation allowing for the existence of the Treaty expired on 31 December 2004. There has been an extension for the submission of applications, for an unspecified period, and many U.S. investors have applied for protection under the Treaty during this period of extension. Technically, the Treaty requires one year’s notice for termination, but at time of writing, there is no official report confirming that such notice has been given either by Thailand or the US. In this connection, those Treaty exemptions are commonly believed to be valid.

It should be noted further that the Treaty benefits for US nationals are currently on the table in the Free Trade Area Agreement (“FTA”) negotiations between Thailand and the US. While a conclusive FTA has not been signed, the Ministry of Commerce, from time to time, turns down Treaty applications by asserting its compliance with the informal direction of the government.

**Implications of FTA Agreements with Other Countries**

The FTAs Thailand has concluded and is currently negotiating with a number of countries are also gradually liberalizing certain restrictions under the FBA in order to further facilitate foreign direct investment. The FTAs with Australia, New Zealand and Japan are already in force and effect. Other FTAs are currently at various stages of discussion or negotiation, such as those with India, Bahrain, Peru and within BIMSTEC (Bhutan, India, Myanmar, Nepal, Sri Lanka, and Bangladesh). Currently, negotiations between Thailand and EFTA (Switzerland, Norway, Liechtenstein and Iceland) have been placed on hold. In addition, a very comprehensive FTA between ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam) and China is also in effect.

Under the Thailand-Australia Free Trade Agreement (“TAFTA”) that came into effect on 1 January 2005, Thailand relaxed some of the ownership restrictions under the FBA. Subject to certain conditions and limitations, Thailand permits up to 60% -100% equity participation by Australian investors for certain business sectors and subsectors (e.g., communication, construction, distribution, education, tourism and travel, and recreational services) without having to apply for a license under the
FBA. There may, however, be minimum registered capital requirements and other conditions, depending on the type of business.

Under the Thailand-New Zealand Free Trade Agreement, effective from 1 July 2005, and subject to certain limitations, New Zealand investors are allowed equity participation of up to 100% in the manufacturing of machinery and mechanical appliances, basic chemicals, natural rubber, food processing using modern technology and certain other activities in Thailand.

Under the Thailand-Japan Economic Partnership Agreement ("JTEPA"), the tariff on most industrial products will be eliminated within 10 years of implementation. Additionally, both countries will cooperate to promote the competitiveness of the auto and auto-components industry, as well as the development of the steel industry. Tariffs will be immediately eliminated on a number of Thai agricultural products including fruits, fishery and forestry products. In addition, JTEPA includes certain commitments on other issues such as trade in services and investment, customs procedures, government procurement, competition, intellectual property rights and movement of natural persons.

It must be emphasized, however, that the extent to which the provisions of FTAs may apply to any particular transaction very much depends on the terms of the relevant FTA and the particular business sector or subsector in question and must be dealt with in detail on a case-by-case basis.

Restrictions on Foreign Participation in Specific Sectors

In addition to the FBA, there are several statutes that impose conditions of majority ownership and management by Thai nationals in specific business sectors. Set out below are some examples of business sectors having restrictions on foreign participation.

The Financial Institution Business Act B.E. 2551 [2008] ("FIBA")

Commercial banks, finance companies and credit foncier companies are primarily subject to the FIBA and regulations stipulated by the Bank of Thailand ("BOT") as the regulator.

The FIBA replaces the Commercial Banking Act B.E. 2505 [1962] and its amendments, and The Act on the Undertaking of Finance Businesses, Securities Businesses and Credit Foncier Business B.E. 2522 [1979], and its amendments. Accordingly, all financial institutions including commercial banks, retail banks, subsidiaries of foreign financial institutions, branches of foreign banks,
representative offices of foreign financial institutions, finance companies and credit foncier companies, are supervised under the same set of regulations.

In relation to the ownership of the financial institutions, the FIBA requires that Thai nationals must hold not less than 75% of the total number of shares with voting rights sold in a financial institution and that at least three-fourths (3/4) of the total number of directors be Thai nationals. However, this limitation can be relaxed at the discretion of the BOT.

Foreign nationals may be allowed to hold up to 49% of the total number of voting shares sold in a financial institution, which is reviewed on a case-by-case basis and upon request. Foreigners are allowed to comprise more than 25% of the company’s voting shares, but not more than 50% of the directorship of a company.


The Life Insurance Act B.E. 2535 (1992), as amended, and the Non-Life Insurance Act B.E. 2535 (1992), as amended, require that Thai nationals must hold more than three-quarters of the total number of voting shares sold and that at least three-quarters of the total number of directors must be Thai nationals.

Furthermore, the laws also empower the Office of Insurance Commission ("OIC"), on a case-by-case basis and upon request, to permit non-Thai nationals to hold up to 49% of the company’s voting shares sold and to allow foreigners to comprise more than one-quarter, but not more than half, of the board of directors of the company.

Moreover, where the financial position or business operations of a company are likely to be detrimental to insureds or the public, the Minister of Finance, with a suggestion from the OIC, may allow the company’s shareholding or directorship structure to differ (e.g., allow the foreign shareholding ratio to be more than 49%).

The amendments to the Life Insurance Act B.E. 2535 (1992) and the Non-Life Insurance Act B.E. 2535 (1992) in 2008 provide that amalgamation may be carried out only between two or more public companies licensed to operate insurance business. The amalgamation of insurance companies must be governed by the PLCA. The insurance companies intending to carry out amalgamation are required to submit to the OIC for approval, a plan detailing the amalgamation. The merged company will be deemed as being licensed to operate an insurance company.

The TBOA requires certain types of service providers in the telecommunication business to be licensed by the National Telecommunication Committee ("NTC"). For instance, telephone service providers in Thailand are generally required to obtain the necessary licenses from the NTC, except those telephone service providers in operation when the TBOA was adopted, which are authorized to operate their telecommunication business in a manner consistent with the TBOA.

Initially, the TBOA limited the percentage of the share capital of particular telephone service providers (i.e., those holding type two and type three licenses) that may be owned by foreigners to only 25%. In addition, the TBOA further restricted that not less than 75% of the directors and all of the authorized directors (that are, under Thai law, directors legally authorized to bind the company) must be Thai nationals. However, pursuant to the amendment to the TBOA in 2006, the foreign shareholding limitation has been substantially relaxed to be not more than 50%, through adopting the definition of “foreigners” as stipulated in the FBA to apply when determining the foreign shareholding in a telecommunication business operator. Furthermore, the special requirement about the minimum number of the directors and the authorized directors, who must be Thai nationals, has also been eliminated.

Thai Vessel Act B.E. 2481 (1938)

This Act imposed a restriction on foreign ownership in a juristic entity owning a Thai vessel operating in Thai territorial or international waters.

With respect to a company owning a vessel operating in Thai territorial waters, at least 70% of the capital in the company must be owned by Thais (either individual or entity) and not less than half of its directors must be Thai nationals. With regard to a company owning a Thai vessel used in international marine transport, at least 51% of the capital in the company must be owned by Thais (either individual or entity) and not less than half of its directors must be Thai nationals.

Employment Provision and Employment Seekers Protection Act B.E. 2528 (1985)

Recruitment agency work is reserved for Thai nationals under the FBA. In addition, both the manager of the establishment and any corporation formed as a recruitment agency must be Thai.
For certain other sectors, such as hotel operation and pharmaceutical dispensing, regulations may require that the individual holder of the license be an individual Thai national. The appropriate government department should be contacted to determine if there are any restrictions on foreign participation in a given sector.

Land Ownership

The Land Code of Thailand generally provides that land may only be owned by Thai nationals or companies in which Thai nationals own 51% or more of the registered share capital and more than half the number of its shareholders are Thai nationals. A foreigner may acquire land in Thailand by virtue of the provisions of a treaty between Thailand and the country of that foreigner that gives the foreigner the right to own land in Thailand and subject to the provisions of the Land Code. However, there is no such treaty at present.

Nonetheless, due to the current policy of the government to boost investment by foreigners in Thailand, the Land Code has been amended to allow foreigners who bring into Thailand not less than THB40 million for at least a five-year investment in government bonds, property funds, investment-promoted companies or business, to own land for residential purposes with an area of not more than 1 rai (equivalent to about 1,600 square meters).

Apart from these provisions of the Land Code, foreigners may be granted permission to own land under particular laws. A foreigner may also own land if his or her businesses have been granted the investment promotion by the Board of Investment (“BOI”) or the land to be acquired is located in an industrial estate zone controlled by the Industrial Estate Authority of Thailand (“IEAT”).

While it is possible for a company with non-Thai shareholders to own land, if there are any foreign shareholders in that company, the Thai shareholders will be required by the relevant land office to demonstrate that they have the source of funds to invest in such company and are not merely nominees of the foreign shareholders, and that the company has not been organized in an attempt to circumvent the prohibition against foreign ownership of land.

There are significant penalties imposed on any person found to have acquired land as an agent of a foreigner or company. These penalties include a fine not exceeding THB20,000 or up to two years’ imprisonment, or both.

When considering the purchase of land in Thailand, a land due diligence should be carried out at the relevant land office and particular care should be given to the verification and examination of the title, the site, the likelihood of title revocation.
due to illegal issuance of title documents, overlapping with public land or forest reserves, the availability of utilities and access, zoning and building restrictions, and the encumbrances on the land.

**Condominium Ownership**

The above restrictions on foreign land ownership are relaxed with respect to condominiums or strata titles. Although the condominium owner has an ownership interest in the land on which the building rests, the Condominium Act B.E. 2535 (1992), as amended, specifies five situations in which foreign individuals or juristic persons are entitled to own condominium units. However, the total condominium units owned by foreigners may not exceed 49% of the total floor area of all of the condominium units in each development.

Condominium development, although not one of the restricted businesses listed in the schedules of the FBA, is also restricted as far as foreigners are concerned. The reason is that one of the criteria of condominium registration is that the project owner must own the land and building(s) which are intended to be registered as a condominium. This then reverts to the fact foreigners are prohibited from owning the land under the Land Code.

**Property Fund**

Since 1997, the SEC has allowed licensed fund management companies to establish immovable property mutual funds as another vehicle to mobilize both domestic and overseas funds for investment in immovable properties in Thailand. There have mainly been two types of property funds in Thailand, private and public property funds, depending on the required level of exposure to the public of the fund.

Only public funds are now open for new applications, while new private property funds can no longer be established. Units in an existing private property fund may however be bought, but no new investment is allowed and all private property funds are required to be dissolved by August 2015 unless specific exemption has been granted by the SEC.

According to the current regulation, the investment units of a newly established public property fund, which makes investment in land ownership, can be held by foreign unit holders (alone or in aggregate) up to 49%, subject to certain requirements (e.g., any unit holder cannot hold more than one-third of the total investment units in a public property fund). Furthermore, as a legal entity, the property fund can therefore invest in land, immovable property and other assets, such as bonds, deposits, as set forth in the relevant SEC regulations. All of the
funds receive a wide range of tax privileges, including exemption of 23% corporate income tax, no specific business tax, no stamp duty and a lower registration fee for the fund’s purchase of immovable property.

**Real Estate Investment Trusts (“REITs”)**

The SEC is now in the process of preparing sets of notification regarding the establishment and management of REIT in Thailand, which is expected to be in effect in late 2012. REIT uses the model of “trust” under the Trust for Capital Market Transaction Act B.E. 2550 (2007). The establishment and management of REIT will be governed by the SEC. REIT will replace the existing format of the Property Fund for Public Offering (“PFPO”) which is under the “mutual fund” concept, and relax some restrictions under the PFPO, such as borrowing restriction, holding ratio and permissible investment, to be in line with international standard. In addition, REIT will also introduce the property-owner driven scheme and allow the real estate expert to manage the REIT.

**Investment Promotion**

Companies operating in Thailand may be granted special privileges by the BOI so as to promote their investments. These privileges include land ownership, 100% foreign ownership for certain businesses, and tax and duty exemptions. Conditions are, however, often attached to such promotional privileges. For example, conditions specifying a minimum registered capital requirement or the minimum ratio of Thai national shareholders may apply to certain promoted investment project.

In merging with, or acquiring by way of a share acquisition, a company which has been granted privileges by the BOI, it is important to review the rights and privileges granted and the conditions imposed by the BOI to ensure that the rights and privileges are utilized to their best advantage. In addition, it is important to ensure full compliance with the conditions stipulated by the BOI because it has the authority to withdraw the rights and privileges in the case of a breach of conditions, including the recall of exempted tax and duty.

In the case of assets acquisition, the company acquiring the assets of the other company, which has been promoted by the BOI, may apply to transfer the investment promotion for such assets. In such case, the funding used in acquisition shall have a debt to equity ratio of no more than 3:1. If the permission to receive the transfer is granted, the transferee will receive the remaining rights and privileges of the transferor and will be bound to the conditions imposed by the BOI.
Other Investment Incentives

The Industrial Estate Authority of Thailand Act B.E. 2522 (1979)

The Industrial Estate Authority of Thailand Act provides for two categories of industrial estates: general industrial estates and export free zones.

Currently, there are general industrial estates in the Bangkok vicinity and various parts of Thailand. These estates are operated by IEAT, either solely or in joint venture with private companies or government agencies. There are also privately-owned industrial estates, which are themselves BOI-promoted enterprises.

Location in an industrial estate sometimes appears as a requirement for BOI promotion. BOI-promoted industries located within industrial estates (whether privately owned or not) are eligible for preferential treatment. By setting up in an industrial estate, investors can also satisfy subsidiary requirements of their respective investment promotion zones and benefit from the estate’s established industrial infrastructure and the proximity of complementary industries.

Industrialists locating in government-sponsored estates also receive a set of incentives irrespective of whether or not they are eligible for BOI promotion.

Free Zones are part of industrial estates. The IEAT can grant certain tax privileges to non-BOI promoted, foreign or Thai investors who establish commercial operations in approved Free Zones. The privileges include exemption from import and export duties, as well as from Value Added Tax ("VAT") on machinery, equipment, tools, raw materials and supplies that are essential for production, and on goods imported for use in production. Such privileges are similar to those provided to promoted companies by the BOI.

The Petroleum Act B.E. 2514 (1971)

The Petroleum Act provides concessionaires with privileges similar to those provided to BOI-promoted projects, such as assurances against nationalization, plus permission to own land, bring in foreign skilled workers and experts, and to remit currency abroad, as well as certain exemptions from taxes and duties.

Additional Incentives

Additional incentives are provided under other statutes and by other organizations if goods are produced for export. The following is a brief summary of some of the privileges available.
Customs Duties

The Customs Department can refund import duties on materials imported for the production of goods that are then exported. In addition, if a manufacturing firm exports its products, it is possible (against certain guarantees and fees) to procure an exemption from import duties on materials to be incorporated in manufactured products under bonded warehouse status. However, if the exemption applies, there are also detailed reporting requirements.

Taxation

Zero percent of VAT applies to goods produced for export.

Packing Credit

Exporters may obtain financial assistance from commercial banks in the form of a packing credit by means of discounting promissory notes at a rate prescribed by the commercial bank.

Competition Aspects

The Trade Competition Act B.E. 2542 (1999) ("Competition Act") prohibits any merger or acquisition that would create a monopoly or lead to unfair competition, unless permission is first obtained from the Trade Competition Commission prior to the merger or acquisition.

Share acquisitions, asset acquisitions, and amalgamations all fall within the ambit of the Competition Act.

Pursuant to the Competition Act, a merger is defined to include, among other things:

- a merger between two or more manufacturers, sellers or service providers, causing one business to be terminated or causing the two businesses to be merged into a new business;
- an acquisition of the whole or part of another business’ assets in order to control the business policy, administration or management; and
- an acquisition of the whole or part of another business’ shares in order to control the business policy, administration or management.

The commission has the full authority to prescribe the conditions of mergers that are required to obtain pre-merger permission, including the criteria regarding combined market shares, sales turnover, amount of capital/shares or assets. However, the Trade Competition Commission has yet to prescribe any conditions of this kind.
To procure such permission, the applicant must submit an application for permission to the commission in accordance with its procedures, criteria and conditions, which will be published from time to time in the Government Gazette. At time of writing, no procedure, criteria nor conditions have been announced.

Detailed regulations with respect to what constitutes a monopoly or unfair competition resulting from an M&A have not yet been laid down in the Competition Act. As a result, the provisions of the Competition Act, despite being enacted, are not yet implemented. Nevertheless, there was a proposal from the commission on the criteria of a monopoly or unfair competition caused by an M&A that should be subject to the pre-merger, as follows:

- For all general businesses, except financial and securities businesses, any merger or acquisition with a business with more than one-quarter market share and a sales turnover of THB5 billion or more prior to the merger or acquisition, and after the merger or acquisition the market share will be one-third and the sales turnover THB5 billion

- For financial and securities businesses, any merger or acquisition with any business with more than one-quarter market share and sales turnover of THB100 billion or more prior to the merger or acquisition, and after the merger or acquisition the market share will be one-third and the sales turnover THB100 billion.

The prescription in regard to M&A does not require the approval of the Cabinet. The commission, by the signature of its chairman, can issue a prescription and announce it in the Government Gazette for it to become effective. Nonetheless, to date, the commission has not officially issued or announced this prescription. Therefore, at time of writing, no merger of any type need to obtain permission from the commission.

It is worth to note, however, that if any M&A results in any business operator having a dominant position, that business operator is prohibited by the Competition Act from abusing its dominant position (i.e., imposing unfair prices for purchase and sale of goods or services, imposing unfair conditions towards customers, or ceasing, reducing or limiting service without reasonable cause). According to the Competition Act, the requirements of a “dominant position” will, from time to time, be determined and prescribed by the commission.
In January 2007, the commission announced the prescription regarding the threshold on market dominance that effectively applies to all industries. A business operator is considered to have a dominant position if it is:

- a business operator with 50% market share or more, and sales of THB1 billion or more in the previous year; or

- any of the top three business operators in a particular business with a combined market share of 75% or more, and combined sales turnover in the previous year of THB1 billion or more, whereby all three would be classified as dominant players, except for the business operator which individually has a market share of less than 10% or a sales turnover in the previous year of less than THB1 billion.

In addition to the Competition Act, there are prohibitions imposed under other laws against mergers or acquisitions that would create a monopoly or lead to unfair competition in some business sectors such as the energy business and the telecommunication business.

**Energy Business**

On 13 January 2010, the Energy Business Supervision Committee Regulation Re: Prescribing the Criteria for Preventing Mergers which Constitute a Monopoly, and Reduce or Limit Competition in the Energy Business Provision (Merger Control Regulation) was announced in the Royal Gazette, and came into effect on 14 January 2010. The Merger Control Regulation was enacted by virtue of the Energy Business Operation Act B.E. 2550 (2007) (“EBOA”), with the intention of controlling and preventing “licensed energy business operators” (i.e., electricity, natural gas or energy network system business), under the EBOA (the “Licensee”), from engaging in merger activities with other Licensees, unless an approval from the Energy Business Supervision Committee has been obtained.

Merger activities that require prior approval from the committee include:

- the merger/amalgamation between two or more Licensees, which results in the cessation of one business operation, or it becoming a new business operation;

- the acquisition, or any action taken in order to acquire all, or certain parts, of the assets of other Licensee(s), resulting in the acquiring Licensee having the power to control the policy, and to administrate, direct or manage the operation;

- the acquisition, or any action taken in order to acquire, all or some of the shares of other Licensee(s), resulting in the acquiring Licensee having the power to control the policy, and administrate, direct and manage the operation; or
• the acquisition, or any action taken in order to acquire all, or some, of the shares of a person who currently possesses the power to control the policy, or is also in charge of administering the operation, directing and managing the other Licensee’s operation, or to enter into a partnership arrangement with the said person.

The Merger Control Regulation also requires the Licensee to immediately inform the committee in the event of the following significant circumstances:

• The Licensee wishes to enter into a contract or an agreement which results in any person having total or partial power, either directly or indirectly, to administrate or manage the operation of the Licensee.

• The Licensee undertakes any takeover activities, or is taken over, in a manner as stipulated under the Securities and Exchange Law.

• The person, who has the power to control the policy, and administrate, direct and manage the Licensee’s operation, has or gains the same controlling power, either directly or indirectly, in another Licensee’s operation.

If the committee views that the above significant circumstances might create a monopoly, or reduce or limit competition in the energy business sector, the committee is entitled to order the Licensee to cease or revise the monopolistic activities; or amend the conditions stipulated in the license to operate the energy business.

To obtain an approval from the committee, the Licensee must submit an application, prior to the completion of the merger process, specifying the reasons, needs, procedures and the period of time needed to proceed with the merger.

In considering the application, the Committee will take into account the following factors:

• The provision of energy according to economic principles
• Market structure and the level of competition in the relevant market
• Type of license to operate the energy business
• Market share enjoyed in the energy business
• Other factors or conditions under the trade competition law, and other relevant laws, and, in particular, taking the following into consideration: public interest, consumer protection, new operators entering into the market, and competition in relevant markets.
Insurance Business

Mergers and acquisitions became a subject of interest for the insurance industry once again when the second amendment to the Life Insurance Act and Non-Life Insurance Act (collectively, the “New Acts”), were enacted in early 2008.

There are several reasons for this, particularly: (i) the New Acts introduced the “Risk Based Capital” or RBC scheme - many observers believed this scheme would lead to mergers and acquisitions of small- and medium-sized insurers, as their survival mechanism; (ii) all the existing private limited insurance companies must be transformed into public limited companies within early February 2013, therefore, insurance companies will be governed by more stringent principles and higher standards for good corporate governance; (iii) the New Acts also imposes new requirements and procedures regarding the company’s operations, such as new procedures for the establishment of a new insurance company, the payment of the annual operating fee, and the sale and advertising of insurance products; (iv) the New Acts provides mechanism for transfer of business and amalgamation among insurance companies, in that the directors of the companies are required to propose the plan specifying the details of the company’s operation to the OIC; in this regard, the transfer of business or amalgamation will be subject to the OIC’s approval and conditions as may be stipulated by the OIC; and (v) the OIC supports the mergers and acquisitions to strengthen the position of the insurance companies in Thailand.

However, even with the OIC’s ardent support of M&As, there are further steps that could be taken to encourage a more friendly insurance merger market in Thailand. For instance, in terms of business transfer, in theory, consents from all policyholders must be obtained for the transfer of insurance policy to a new company and the law does not waive this requirement. Furthermore, the tax issue on the amalgamation and business transfer of insurance companies is also one significant hurdle for mergers and acquisitions between insurance companies.
Telecommunication Business

In respect of the telecommunication business sector, the Notification of the NTC (the “Telecommunication Notification”) was issued on 8 September 2006, by virtue of the Act on Organisation to Assign Radio Frequency Spectrum and to Regulate the Sound Broadcasting, Television Broadcasting and Telecommunication Services B.E. 2543 [2000] and the TBOA to prevent an act that could lead to a monopoly or unfair competition.

The Telecommunication Notification provides that in addition to prohibitions under the Competition Act, licensed telecommunication business operators (the Licensee) are prohibited from acquiring more than 10% of total shares of other licensees or acquiring part of or all the assets of other licensees to gain control over the policy or business administration of other licensees either directly or indirectly unless permission is first obtained from the NTC.

The Licensee is also required to inform immediately the NTC in the event that the Licensee undertakes any takeover activities, or is taken over, in a manner as stipulated under the relevant Thai securities laws.
Tender Offer and 5% Threshold Reporting Requirements

Under the SEC Act, any person who has acquired securities up to the percentage that is significant to the management of a public listed company may be required to make a tender offer to purchase all securities of such company. Apart from the tender offer requirement, the SEC Act also provides certain provisions and notifications that can help alert target companies and shareholders of those target companies be aware of any attempts of acquirers to acquire securities up to the extent that could lead them gaining material voting rights. To that end, the SEC Act requires any person who has acquired or disposed of securities (including equity-linked securities) that reaches or passes through any multiple of 5% of the total number of voting rights of such business to report his or her acquisition or disposition to the Office of the SEC within three business days. This requirement can be considered an early warning mechanism that enables target companies and their shareholders to be aware of every 5% change in the percentage of the voting rights so that they can, in time, seek any preventive measures on a fair basis.

Report on Acquisition/Disposition of Securities

The SEC Act requires a person who acquires or disposes of securities in a public listed company that reaches or passes through any multiple of 5% of the total number of voting rights of such business to report such acquisitions or dispositions to the Office of the SEC. This provision provides important protection for investors by enabling them to be aware of changes in the percentage of voting rights in a particular company.
For ordinary shares, the calculation of the 5% threshold is based on the following formula:

\[
\frac{\text{Number of voting rights held} \times 100}{\text{Total voting rights in the business (excluding treasury stocks)}}
\]

The calculation for convertible securities shall not be added together with ordinary shares for the purposes of the 5% threshold calculation. The following formula applies to the calculation of the convertible securities:

\[
\frac{\text{Number of voting rights to be held after exercising all convertible securities} \times 100}{\text{Total voting rights in the business (excluding treasury stocks and those voting rights exercisable from the shares reserved for convertible securities)}}
\]

**Acquisition Date**

Benchmarking the acquisition or disposal date is important because the report on the transaction must be submitted to the Office of the SEC within three business days from the date of acquisition or disposal. In relation to the existing shares, the acquisition date is the date of the transaction. For newly issued shares, the acquisition date is the date on which the company registers the increase in its paid-up capital with the Ministry of Commerce. As for newly issued convertible securities, the acquisition date is the date on which the company issued such convertible securities.

**Group Reporting**

Under Thai securities law, two or more persons may collectively form or be deemed as a group for the purpose of reporting their acquisitions of securities in a business to the SEC if these two or more persons have intentions to acquire and/or hold the shares in a public listed company together. The duty to report will be based on the aggregate number of voting rights held by all persons in the group and their related persons.

**Acting in Concert**

Although the Office of the SEC had attempted to promulgate a new notification to set out the requirements for persons jointly acting for the purpose of business
takeover or so-called “acting in concert,” such effort has turned out to be fruitful recently. At present, there is an official notification issued by the SEC prescribing the criteria for determining relationship or actions that constitute an act in concert, which has been in effect since 1 August 2009.

Pursuant to the said notification, acting in concert is defined to mean a situation, whereby:

• any person shares an intent with another person(s) to exercise their voting rights in a coordinated manner, or causes another person(s) to exercise his or her voting rights for the purpose of controlling the voting rights or jointly controlling the business; and

• such person has relationships or coordinated his or her conduct with any person in any of the following ways, among others:

  - nature of agreements, such as having an agreement to act with respect to the exercise of voting rights held by the parties thereto in a coordinated manner, an agreement to allow any party thereto to exercise the voting rights on behalf of other parties, or any standstill agreement regardless of whether such agreement is made in writing or otherwise;

  - nature of particular relationships, such as becoming a partner in a partnership, or becoming a director or an officer of the company or any other juristic person, and representing or conducting himself or herself in such a way as to represent that he or she holds the securities of the business on behalf of or jointly with such partnership, company or other juristic person, or causing any person to exercise, on a regular and continual basis, his or her voting rights at the shareholders’ meeting of the business, regardless of whether such person is a shareholder of the business (but excluding the granting of authority to an independent director, custodian or proxy voting service to attend a meeting and to exercise voting rights on his or her behalf); or

  - nature of behavior, such as personally or through a designated person, soliciting any person for the purpose of acquiring or disposing of the securities of the business at the same time, or at approximately the same time, or having a common source of funds or doing any action through whatever means that constitutes assistance in acquiring a source of funding with the intent of using such funds to purchase or to otherwise act to acquire the securities of the business for any persons.
Related Person

Securities held by certain related persons are deemed to be held by the same person and thus must be taken into account when calculating the 5% threshold, or when determining the obligation to report the acquisition or disposal of securities and the obligation to make a mandatory tender offer for securities in a business. Related persons include those persons listed under Section 258 of the SEC Act, which include spouses and minor children; ordinary partnerships in which such person or his or her spouse or minor child is a partner; or, broadly speaking, limited partnerships and companies in which such person or his or her spouse or minor children or the ordinary partnership hold more than 30% of the total contribution or share capital. Under the current applicable SEC Act, the definition of a related person has been expanded to include the shareholding of the related person(s) in every shareholding level (both upward and downward shareholding levels). Careful analysis of the details and implications of these provisions must be taken into serious consideration prior to acquiring or disposing of any securities in public listed companies in order not to breach the share acquisition/disposal reporting requirement and the tender offer requirement.

Persons subject to the securities reporting requirements under Section 246 of the SEC Act are required to disclose any related person(s) and concert party of the immediate holding entities, the intermediate entities and all companies in the chain involved with the reported securities. In addition to the securities acquisition or disposal, persons that are obligated under Section 246 must report any change to securities holding that is caused by the beginning or termination of a relationship with concert party, or the beginning or termination of relationship with related persons that triggers the reporting obligation under Section 246 of the SEC Act.

Non-Voting Depository Rights (“NVDR”)

According to the current applicable regulation promulgated by the SEC, any person subject to the reporting requirements under Section 246 of the SEC Act is required to disclose in Form 246-2 the information pertaining to his or her holding of NVDRs (if any), of which the underlying securities are the reported securities, in addition to those reported securities acquired or disposed of which exceed or fall short of the 5% threshold. However, NVDR holdings to be reported on Form 246-2 are not required to be aggregated to other securities held by such person for the purpose of the threshold calculation.

In addition to the reporting requirement on Form 246-2, under the prospectus of the Thai NVDR Company Limited, any person who acquires or disposes NVDRs
or NVDRs together with the underlying securities (i.e., shares or convertible securities) and thereby increases or decreases the number of underlying securities and NVDRs representing such securities altogether reaching or through any multiple percentage of the total voting rights (either a listed or non-listed public limited company in the SET), is required to report to the Thai NVDR on Form 246-2 NVDR. Moreover, the reports to the Thai NVDR must be prepared and submitted separately between NVDRs representing shares and NVDRs representing convertible securities.

**Tender Offer Requirements**

The SEC Act requires any person, or person(s) acting in concert with others, who has acquired securities up to the percentage that is significant to the management of the target company (the trigger point) to make a mandatory tender offer. The rationale behind this requirement is to allow the existing shareholders to have an opportunity to sell their own securities when there is a significant change to the control of the company.

**Trigger Points**

Previously, the trigger point was only based on the number of shares held by a person and its related person(s). This has been changed and the trigger point is now also based on the proportion of voting rights acquired by a person, related person(s) and any person with whom the acquirer acts in concert. The current trigger point is prescribed as:

1. either 25% of all issued shares of the business, or 25% or more of common shares of the business that has also issued preference shares representing less than 1 vote per 1 preference share. (An acquirer, however, may be exempted from the Tender Offer Obligation under this clause if the shares acquired by the acquirer are less than 25% of the total voting rights of the business);

2. 50% of the total voting rights; or

3. 75% of the total voting rights.

Note that under current securities regulation, the following circumstances are regarded as grounds for exemptions from the requirement to make a mandatory tender offer:

- Acquisitions of shares of non-listed companies
• Shares acquired through inheritance

• Acquisitions of additional shares that arise from payment of share dividends or by subscription to shares in proportion to existing shareholding ratio in a right offering

• Acquisitions of securities that convey non-voting rights, e.g., Thai Trust Fund

• Reduction of shareholding to an extent lower than the trigger point within seven business days from the date on which the obligation to report share acquisition or disposal is triggered pursuant to Section 246 of the SEC Act and such reduction is achieved through selling the securities on the exchange or through the transfer of such securities back to the transferor

• Partial tender offer

• Waiver of the obligation to make a tender offer as granted by the Office of the SEC

Acquisition Through Chain Principle

A tender offer is also required when any person acquires a significant degree of control of a juristic person with an existing shareholding in a business (immediate holding entity), either directly or indirectly through his or her shareholding in, or control of, other juristic persons (intermediate entities). In other words, a tender offer is required when a person controls a company through another company that he or she also controls, or through a chain of similar companies.

If the aggregate shareholding of any person in control of such entity(ies), intermediate entity and holding entity and any related parties, reaches or exceeds a trigger point as mentioned above, a tender offer must be made. Whether a person is in control of such entities is defined in two ways: by holding shares representing 50% or more of the total voting rights in the immediate holding entity (in the case of direct control) or in the intermediate entity (in the case of indirect control); or the power to control the management or operation of the relevant entity through the nomination of a substantial number of directors.

Waivers

Prior to the acquisition, the acquirer can seek a waiver from the Office of the SEC where:

• the acquisition does not result in a change of control of the business so acquired;

• the acquisition is made for the purpose of providing support to or rehabilitating the business;
• an acquisition of newly issued securities is made pursuant to the resolution of a shareholders’ meeting of the business, authorizing the issue of such new securities to that person without the requirement to make a tender offer for all securities of the business (whitewash) in compliance with the rules prescribed by the Office of the SEC;

• there exists any other circumstance pursuant to which a precedent has been set by the takeover panel (as elaborated further below); and

• there exists any other reasonable and appropriate grounds.

Note that the granting of the above waivers is within the discretion of the Office of the SEC. However, the granting of the waiver is within the discretion of the takeover panel where:

• the acquisition of a significant degree of control of the immediate holding entity (under the chain principle) does not purport to make a business takeover; or

• there is any other circumstance that, in the opinion of the Office of the SEC, should be considered by the takeover panel.

Takeover Panel

A takeover panel has now been created from a list approved by the SEC, with members appointed by the Secretary-General of the SEC.

Appointment is based on qualifications to serve the panel, that is, knowledge, skills and experience. The takeover panel has a number of responsibilities, including considering and issuing orders in relation to the grant of waivers, determining the tender offer price and similar matters. The takeover panel also has the function of advising the Office of the SEC and the SEC on takeovers and related issues.

Competing Bid

A tender offer can be made at any time on a voluntary basis. Where there is a competing bid, the first offeror is able to improve the condition(s) of his or her tender offer, such as raising the tender offer price or extending the period of the tender offer (to a date not exceeding the final day offered by the competitor). This flexibility is intended to promote fairer competition for the benefit of investors and to enable the first offeror to remain in competition with its rivals.
Tender Offer for Delisting Purpose

There are additional detailed provisions that require the making of a mandatory tender offer and establish the minimum amount of such an offer should the acquirer wish to delist the target company. This is aimed at protecting the interests of the other shareholders.

Tender Offer Price

As a general rule, the tender offer price must not be lower than that of the highest price the offeror has acquired within 90 days. In cases of acquisition of only either common shares or preferred shares, the tender offer price of non-acquired shares must not be lower than a five-day weighted average market price before the acquisition date of acquired shares or fair value appraised by a financial adviser, whichever is higher.

As for delisting, the tender offer price must not be lower than one of the following prices:

- The highest acquired price within 90 days before the date on which the tender offer is submitted to the Office of the SEC commencement of the tender offer
- The five-day weighted average market price before the board of directors approves the delisting
- The net total asset that is marked to market
- The fair price appraised by a financial adviser

Opinions of the Target Business in Relation to Tender Offer

When a tender offer is made, the target company must submit its opinion to the Office of the SEC, with copies distributed to the SET and all shareholders within 15 business days from the date on which the tender offer has been received. Additional opinions must be prepared for any revised offers, unless special circumstances apply. Such circumstances generally relate to the latest offer being more favorable and the company’s financial adviser having already expressed an opinion on the issue of acceptance.
Frustration Action

Under the latest amendment to the SEC Act, there is an adoption of the frustration action concept, which is applied particularly to takeover transactions. The SEC has promulgated a notification outlining the detailed specification of frustration actions that may affect a tender offer, and thereby have to be approved by the general shareholders’ meeting or otherwise waived by the Office of the SEC. Circumstances that may be regarded as a frustration action includes, among others, a significant increase of the registered capital, an issuance and offer for sale of convertible securities, an acquisition or disposition of material assets that are essential to the operation of the business, or an implementation of a stock repurchase scheme.

Public Limited Companies Law

The Public Limited Companies Act (No. 2) B.E. 2544 (2001) (PLCA) came into effect on 4 July 2001. Set out below are six major issues in the latest amended PLCA that benefit public limited companies, including those converted from private limited companies.

• **Share's Par Value** - There is no longer a minimum share’s par value requirement that was previously prescribed at not less than THB5 per share. However, all shares of a public company are required to be of the same par value.

• **Conversion of Debt into Equity** - Generally, share subscribers or purchasers cannot set off their debts against the payment of shares issued by a public company. However, the amended PLCA allows the company to set off its debt by issuing new shares as payment to its creditors, pursuant to the conversion of debt into equity project. The process must be approved by 75% of the shareholders who attend the shareholders’ meeting and are entitled to vote.

• **Share Buyback** - The company is entitled to buy back its shares from its shareholders who vote against a resolution of the shareholders’ meeting on the amendment of the company’s Articles of Association regarding the right to vote and receive dividends, and which the shareholders themselves consider unfair. The company can also buy back its shares for financial administration purposes when the company has retained earnings and liquidity surplus, provided that such share buyback must not cause the company a financial problem following the rules and procedures under the Ministerial Regulations.
• **Voting Rights of Preferred Shares** - The company may fix the voting rights of preferred shares at less than one vote (e.g., one vote for every two preferred shares held).

• **Reserve** - The amended PLCA allows the company, upon obtaining an approval from the shareholders’ meeting, to transfer its premium reserve, statutory reserves or other reserves to compensate for its accumulated losses.

• **Capital Reduction** - The amended PLCA allows the company, with remaining accumulated losses after having transferred its reserves to compensate for the accumulated losses, to reduce its capital to less than one-quarter of the total capital.
Normally, labor or employment issues would arise in relation to amalgamation and asset acquisition, but not for share acquisition. This is because in the case of share acquisition, the target company, as an employer, continues its operations. The share acquisition only results in the change to the shareholding structure of the target company without creating any impact to the company’s labor.

Amalgamations

Section 13 of the Labour Protection Act B.E. 2541 [1998] (the “LPA”) provides that, where there is a change of an employer due to a transfer, inheritance or any other reasons, or where the employer as a legal entity transfers or merges with any other legal entity, all rights of the employees towards the former employer shall remain unaffected, and the new employer shall assume all the rights and duties of the former employer towards the employees.

Upon amalgamation, an employment will be deemed to continue in force, unless an employee expressly refuses to continue his/her employment with the new company. The new company must assume both rights and duties in relation to the employment from the former employer. If the employee refuses to work with the new company, the employment would be deemed terminated immediately upon the amalgamation, even if the employees are to perform the same work (in the same position) in the new company. In such case, the new company must assume the severance pay duty from the former employer and pay severance to the employees who do not consent to the transfer of employment.
Where a transfer of employment is a result of a business/property acquisition, the transfer of employment does not take place automatically. Without consent from employees, either express or implicit, the employees will remain the employees of the selling company, and their employment would be terminated by the selling company. At the time of the transfer of employment, the new employer may not change the existing employment terms and conditions if the changes will result in the employees receiving less favorable employment terms and conditions, unless consent is obtained from the employees.

In addition, under section 45 of the Labour Relations Act B.E. 2518 (1975) (the LRA), employees working in a company which has 50 or more employees may among themselves establish an employees’ committee. Generally, an employer cannot dismiss an employee who is a member of such employees’ committee, or perform any act which may result in such employee being unable to continue working unless permission is obtained from the relevant competent labor court. Therefore, at the time of amalgamation, if an employee who is also a member of the employees’ committee does not consent to work with the new company, the employment of such employee will be deemed terminated and the new company must apply for permission from the competent labor court in accordance with the LRA.

The LRA also provides protection for employees against dismissal in case where there is a demand for a collective bargaining agreement or amendment thereof, or where the company has entered into a collective bargaining agreement with employees or the labor union. Like in the case of the employees’ committee, an employer cannot dismiss employees who are representatives of employees, members of the labor union or members of the labor federation involved in the demand unless such employees are in serious breach of work regulations such as committing a criminal offense against the employer or neglecting their duties for three consecutive days without justifiable reason. This protection for employees under the LRA must be taken into consideration at the time of amalgamation to ensure that the employment of employees who do not consent to work in the new company is not terminated in violation of the LRA.
Asset Acquisitions

A merger in the form of an asset acquisition does not, in principle, affect the employment relationship between the transferor and its employees because the transferor remains the employer regardless of whether or not it will continue its business operations. However, if the transferee wishes to hire any employee of the transferor, the transferor’s employees will need to be transferred to the transferee. In such case, the employees must consent to the transfer of their employment, and they must be entitled to the same rights and benefits they previously enjoyed when working with the transferor. Otherwise, their employment will be deemed terminated and thereby the terminated employees will be entitled to statutory severance pay.
Major tax issues relevant to amalgamations, asset acquisition and share acquisition could be summarized as follows.

Amalgamations

At present, for tax purposes, companies being amalgamated are not required to pay corporate income tax and the new company is entitled to take, for tax calculation purposes, the price of the properties according to those shown in the books of the companies being merged until those properties are later disposed. However, the amalgamation of companies is uncommon in Thailand due to potential tax problems and disadvantages. First, the two companies are deemed to be dissolved and may immediately be subject to a tax audit by the Revenue Department. Second, the losses of the companies being amalgamated cannot be utilized or carried over to be used by the new company.

Regarding the tax consequences of the shareholders of the new company, it is now clear that the shareholders (both individual and corporate) of the new company do not have to pay tax on the capital gains arising from the amalgamation by having received the shares of the new company, subject to certain conditions imposed by the notifications of the Director-General of the Revenue Department. In addition, exemptions also apply in relation to specific business tax and stamp duty (including a land registration fee) on the receipts from the transfer of immovable properties as a result of amalgamation under certain conditions imposed by the Director-General of the Revenue Department.
Note that a transfer of assets under an amalgamation is not considered a sale transaction for VAT purposes and is not subject to VAT.

**Asset Acquisition**

The sale of assets by a corporate entity is normally subject to corporate income tax on net profit. In general, all companies pay a flat rate of 30% of net profits. The Thai government has issued a royal decree to reduce corporate tax rates from 30% to 23% for year 2012, and to 20% in 2013. In addition, in case of a transfer of movable property, 7% VAT will generally be imposed, unless it is a transfer of the entire business and the transferee is in the 7% VAT system. In this case, there will be no VAT applicable on the transfer of movable property. However any VAT in the business transferred must be surrendered. Note that the VAT rate will be increased to the normal rate of 10% from 1 October 2012 onwards, unless there is further extension of such reduction of the VAT rate (i.e., reducing from 10% to 7% as currently applied). However, in cases involving the transfer of immovable property, the transferor will normally be subject to pay 3.3% specific business tax on the gross receipts from the transfer of immovable property, 2% transfer fee, and 0.5% stamp duty (stamp duty may be exempt if the specific business tax is paid). The sale of immovable property is also subject to a 1% withholding tax that can normally be used as a credit against corporate income tax.

At present, for tax purposes, in the case of a transfer of an entire business transfer, the transferor is not required to pay corporate income tax and the transferee company is entitled to take, for tax calculation purposes, the price of the properties according to those shown in the books of the company being transferred until those properties are later disposed. However, the transferor company must be liquidated in the same fiscal year as the transfer of the entire business.

Currently, the transfer of an entire business is exempt from specific business tax and stamp duty, as a result of the current government’s plan to encourage M&A. VAT does not apply to this transfer because the transfer of an entire business does not fall within the definition of “sale” under Section 77/1 (8) [f] of the Revenue Code. Normally, individual and corporate shareholders are also exempt from income tax on capital gains derived from the transfer of an entire business.

The Revenue Department reserves the right to assess taxes based on the market price of any asset transferred, even if that asset was transferred at book value. The company can challenge such a reassessment if it can show a valid reason for selling the asset at book value. In many such cases, there are clearly justifiable reasons for transferring assets at book value, rather than at market price.
Share Acquisition

Normally, capital gains from the sale of shares by a corporate entity carrying on business in Thailand would be included into other income and subject to corporate income tax at the rate of 23% on the net profits. If the share seller company is not carrying on business in Thailand, 15% withholding tax would normally apply on the capital gains, unless exempt under a tax treaty. Where an individual is selling the shares, the capital gains received by the individual would be subject to tax at a progressive rate ranging from 5% to 37%, unless such shares are listed on the SET, in which case there is no tax on any capital gains. If the seller is a non-resident of Thailand, 15% withholding tax may apply on the capital gains, unless exempt under a tax treaty. No VAT is imposed on the sale of shares. The share transfer instrument is subject to stamp duty at the rate of 0.1% on the share purchase price or the paid-up value of the shares, whichever is higher. Certain stamp exemptions for such stamp duty are allowed under the Revenue Code.
PLANNING CONSIDERATIONS FOR M&A TRANSACTIONS

Articles of Association

As the degree of foreign ownership may be limited to less than the majority in a corporation where its businesses are restricted or controlled it is essential to study the Articles of Association carefully before closing a deal. Some of the things to consider include:

- proportionate representation on the board of directors;
- whether or not the foreign shareholders must form part of the quorum necessary to convene meetings to make major financial commitments;
- whether decisions on dividend policy, bylaws and shareholders’ meetings will be by simple majority or if the foreign shareholders must be represented in the majority; and
- which directors will be authorized to bind the corporation.

Due Diligence

Due to risks associated with M&A activities, due diligence should be carried out. First, an acquiring company should ensure that it can actually achieve its central objectives. For example, a foreign share acquirer should ensure that financial incentives granted by the BOI will not be withdrawn if the foreign shareholding in the acquired company rises above a certain percentage, or if an acquisition made with an eye to gaining access to a valuable piece of real estate is out of the
question. In short, it is important to be certain that the target’s crown jewels are actually within reach.

Moreover, with regard to the assets to be acquired, there are several relevant legal issues a potential acquirer should observe and carefully investigate prior to acquisition. This is because some acquirers may be subject to particular restrictions on the type of assets they may acquire. For instance, an asset management company may acquire only non-performing assets, while commercial banks can acquire only performing assets. In addition, different types of receivables possess different legal characteristics, which entail different legal issues. For example, some receivables, such as those generated from leasing agreements between a leasing company and its customers, have continuing obligations attached to them. The transfer of such receivables and obligations in relation to such portfolio may require a novation arrangement, which could prove to be an obstacle due to the need to obtain consent from every customer.

Second, it is vital to make a thorough check for any hidden liabilities. Business in Thailand can be conducted on an informal basis and there can be a labyrinth of obligations that are not immediately apparent when first examining a target company. For instance, whether claims/receivables are in the midst of court proceedings and/or enforcement is a crucial element for a potential acquirer to consider. Due to the risk that a court may strike down a transaction as a trade of claims, which is void on the grounds of a violation of public morals, and due to the legal issue of whether a transferee of claims/receivables can replace either an existing creditor claimant in court or an existing judgment creditor in order to pursue enforcement against the assets of the judgment debtor and other collaterals provided, the acquirer needs to cautiously and considerately take steps to avoid such legal risks. Legal advice is indispensable in these cases, particularly in regard to procedural laws.

In addition, a reputable accounting firm should be engaged to conduct a complete audit and get an indemnity for tax liabilities and any employee-related obligations. It is important to ensure that there are no outstanding obligations assumed by one or two of the directors that have not been divulged to the board.

Usually, due diligence in a share acquisition transaction is much more intense than in an asset acquisition transaction because of the higher risks facing potential acquirers in share acquisition transactions. While potential acquirers generally make preliminary decisions as to how acquisitions should be handled, professional due diligence reports occasionally reveal unexpected or overlooked liabilities, which can affect such decisions and cause a shift in the acquisition strategy to better tackle those previously hidden facts.
In sum, thorough due diligence is crucial to reveal all the weaknesses and strengths of the portfolio or entire business. The findings may result in a change in the acquisition structure.

New BOI Policy

The BOI has announced a new list of businesses eligible for investment promotion under the Announcement of the Board of Investment No. 10/2552, re: Types, Sizes, Criteria, and Rights and Privileges of Each Category of Promoted Business. This announcement repeals the previous list of businesses eligible for investment promotion and replaces it with the list attached to the announcement. The criteria and incentives for some of the businesses eligible for investment promotion have changed in response to changing trends in the economy. Therefore, in a merger with a BOI-promoted company, it will be necessary to examine the new criteria for such specific business which may have been amended in order to determine the feasibility of the merger.

Mergers and Acquisitions as a Result of the Government’s Financial Sector Master Plan

Major changes are taking place in the financial sector and are expected to continue over the next few years as a result of the master plan for Thai financial institutions.

In January 2004, the BOT released the master plan, which sets forth a vision and framework for the development of a Thai financial sector that provides: comprehensive financial services for all potential users, with no significant difference in the level and quality of services between urban and rural areas; an efficient, stable and competitive financial sector, with a balanced composition of available sources of financing (namely financial institutions, debt instruments and the equity market); and fairness and protection for consumers.

The master plan sets forth several measures to increase the efficiency of the financial sector by:

- rationalizing the structure and roles of financial institutions (both domestic and foreign owned) to better meet customer demand, promoting a “one-presence” policy to consolidate a variety of banking functions into a single institution and providing incentives for lending to retail customers and small to medium enterprises;
streamlining rules and regulations to improve the basic infrastructure of financial institutions, resolving tax impediments to mergers, removing regulations that impede financial sector efficiency, strengthening financial institutions and enhancing market mechanisms; and

protecting consumers.

The most dramatic effect of the master plan has been seen in the number of mergers between commercial banks or between commercial banks and financial institutions, some of which have already been completed, allowing the Thai financial sector to enjoy the synergy derived from the integration of the allied international financial institutions. The developments since the implementation of the master plan include:

- the purchase of Siam Panich Leasing Public Company Limited shares by The Siam Commercial Bank Public Company Limited;
- the investment in Bank Thai Public Company Limited by TPG Newbridge;
- the investment in Bank of Ayudhya Public Company Limited by GE Capital International Holdings Corporation;
- the acquisition of Standard Chartered Nakornthon Bank Public Company Limited by Standard Chartered Bank (Thai) Public Company Limited;
- the acquisition of UOB Radanasin Bank Public Company Limited by United Overseas Bank (Thai) Public Company Limited;
- the merger between UOB Radanasin Bank Public Company Limited and Bank of Asia Public Company Limited;
- the investment in Thanachart Bank Public Company Limited by The Bank of Nova Scotia; and
- the sale of shares in Bank Thai Public Company Limited by the Financial Institution Development Fund and the acquisition of Bank Thai Public Company Limited by CIMB Group.

In July 2007, the BOT announced that the master plan for the second phase was in the process. The second plan, expected to be operating between 2010 and 2014, will follow on from the first plan that ran between 2004 and 2007. The goals of the second master plan are to prepare the Thai financial sector to be able to properly respond to the more competitive and volatile environment resulting from the globalization of the financial industry.
According to the BOT, the measures proposed in the second master plan are designed to achieve the following objectives:

- Financial institutions having an efficient corporate governance and risk management mechanism, which shall be strengthened to support national economic growth
- Increase competitiveness in the private sector by financial institutions reducing the cost of funds
- Increase access to financial services to the public at large and better respond to the needs of the people, including strengthening communities and reducing financing from the black market
- Improve infrastructure to promote the growth of the economic system and to facilitate financial institutions’ ability to manage the outstanding non-performing loans which will result in such financial institutions being able to provide better service to customers.

The second master plan is expected to generate a significant increase in M&A activities in Thailand, as evidenced by various M&A deals contemplated after the announcement of the first master plan.
In early 2012, the Cabinet approved the bill of Promotion of Merger and Acquisition of Capital Market (the "M&A Bill"), which had been forwarded to it for approval by the Council of State. The M&A Bill sets out several key issues and measures to improve the conditions and increase the attractiveness of the Thai capital market. The M&A Bill is also set to remove the legal burdens imposed by the current laws and regulations applicable to M&A activities in Thailand.

At present, M&A activities in Thailand endure unnecessary costs and require a prolonged period to complete transactions. The proposed M&A Bill is expected to introduce a special regime to overcome such legal hurdles; for example, the exemption from sending a notice to the obligors in receivable transfer and the shortened period for creditors’ dissent. However, regulators will need to strike a balance between the promotion of M&A in Thai capital markets and the public morale requirement to protect the interests of minority shareholders; for instance, the proper rules to conduct tender offers and the determination of the price of shares to offer to the minority shareholders.

With approval from the Cabinet, the M&A Bill is currently in the process of being forwarded to the House of Representatives and then the Senate for consideration and approval. Once the Senate approves the bill, the Cabinet will submit it to His Majesty the King for final approval and then it will be announced in the Government Gazette, becoming law.
Like most countries, Thailand is taking a proactive stance to address the ongoing financial crisis. The measures imposed by the Thai government include readjusting the legal framework to strengthen the country’s major business sectors. There have been amendments to insurance laws to facilitate M&A transactions among insurance companies to be in line with the government policy aiming to reduce the number of insurance companies while increasing their overall assets size. One major change in the insurance laws in respect of M&A activities is that there is a waiver for the requirements to inform the insurance companies’ debtors of the transfer of their rights under the CCC once there is a transfer of business and amalgamation between those insurance companies.

There have also been new rules and regulations issued to encourage and facilitate M&A activities in some other specific areas of business including energy and telecommunications. A merger or acquisition of a company or companies operating in these areas of business can proceed with no restriction so long as it does not create a monopoly or lead to unfair competition. In respect of the financial sector, the second phase of the BOT Financial Master Plan, once implemented, will bring Thai financial institutions together to a more competitive position. Additionally, in the area of capital markets, the introduction of new M&A Bill will ease and shorten the process of M&A activities. This new M&A Bill purports to make an M&A transaction an even more attractive solution for business operators by substantially reducing or eliminating various legal hurdles associated with M&A transactions.
With several amendments to Thai laws and regulations governing major areas of business and most importantly the proposed new initiative M&A Bill as mentioned above, M&A remains an effective tool for investors in turning crisis into opportunity. Purchasers can benefit from attractive pricing, while sellers should target the right investors so as to enhance and maximize their asset value. Moreover, during this time of recovery in the global economy, we are still optimistic of the ‘win-win’ position either mergers or acquisitions can bring to all players.

While businesses in the collapsing European and US economic regions of the world face challenging times ahead, Thailand’s future may be promising, given its amicable foreign relationship with Myanmar, which has recently opened its doors for foreign investment and trade, as well as the country’s role as a member in the Asia-Pacific Economic Cooperation and the Association of South East Asian Nations. Thailand may find that amidst the economic challenges troubling various countries, it may need to pursue mergers and acquisitions in order to successfully ease into the next phase of bolstering the national economy. Thai corporations must not only find ways to survive such financial times but also to grow and thrive. Mergers and acquisitions will assist the country in recovering from the economic slump and will without a doubt play a significant role in its future development, especially with Thailand’s role in the global market and its ties with countries in the region.
Schedules to the Foreign Business Act B.E. 2542 (1999)

Restriction details on foreign investment in Thai business activities.

Schedule One

Businesses that foreigners are not permitted to do for special reasons:

(1) Newspaper undertakings and radio or television station undertakings
(2) Lowland farming, upland farming or horticulture
(3) Raising animals
(4) Forestry and timber conversions from natural forest
(5) Fishing for aquatic animals in Thai waters and Thailand’s Exclusive Economic Zone
(6) Extraction of Thai medical herbs
(7) Trade in and auctioning of Thai ancient objects or ancient objects of national historical value
(8) Making or casting Buddha images and making monk’s bowls
(9) Dealing in land
Schedule Two

Businesses concerning national security or safety with an adverse effect on Thai art and culture, customs or native manufacture/handicrafts, or with an impact on natural resources and the environment:

Group 1 - Businesses concerning national security or safety:

(1) Production, disposal (sale) and overhaul of:
- firearms, ammunition, gunpowder, and explosives;
- components of firearms, ammunition and explosives;
- armaments, military vessels, aircrafts or conveyances; and
- all kinds of war equipment or their components.

(2) Domestic transport by land, water or air, inclusive of the undertakings of domestic aviation.

Group 2 - Businesses with an adverse effect on Thai art and culture, customs and native manufacture/handicrafts:

(1) Dealing in antiques or objects of art that are works of art, and Thai handicrafts

(2) Production of wood carvings

(3) Raising silkworms, producing Thai silk threads, and weaving and printing patterns on Thai silk textiles

(4) Production of Thai musical instruments

(5) Production of articles of gold or silver, nielloware, nickel-bronze ware or lacquer ware

(6) Production of crockery and terra cotta ware that is Thai art and culture

Group 3 - Businesses that have an impact on natural resources or the environment:

(1) Production of sugar from sugarcane

(2) Salt farming, inclusive of making salt from salty earth

(3) Making rock salt

(4) Mining, inclusive of stone blasting or crushing

(5) Timber conversions to make furniture and articles of wood
Schedule Three

Businesses that Thais are not ready to compete in undertakings with foreigners:

1. Rice-milling and production of flour from rice and farm plants
2. Fishery, limited to the propagation of aquatic animals
3. Forestry from replanted forests
4. Production of plywood, wood veneer, chipboard or hardboard
5. Production of (natural) lime
6. Accounting service undertakings
7. Legal service undertakings
8. Architectural service undertakings
9. Engineering service undertakings
10. Construction, except:
   - construction of things that provide basic services to the public with respect to public utilities or communications and that require the use of special instruments, machinery, technology or expertise in construction and a minimum capital of the foreigner of at least THB500 million; and
   - other categories of construction as stipulated in the Ministerial Regulations.
11. Brokerage and agency undertakings, except:
   - trading in securities or services concerning futures trading in agricultural commodities, financial instruments or securities;
   - trading in or the procurement of goods and services needed for production by, or providing the services of, an enterprise in the same group;
   - trading, purchasing (for others) or distributing or finding domestic or overseas markets for selling goods made domestically or imports as an international trading business, with a minimum capital of the foreigner of at least THB100 million; and
   - other lines of business stipulated in the Ministerial Regulations.
[12] Auctioning, except:

- international bidding that is not bidding in antiques, ancient objects or objects of art that are Thai works of art, handicrafts or ancient objects, or of national historical value; and

- other types of auction as stipulated in the Ministerial Regulations.

[13] Domestic trade concerning indigenous agricultural produce or products not prohibited by any present law

[14] Retail trade in all kinds of goods with an aggregated minimum capital of less than THB100 million or a minimum capital for each store of less than THB20 million

[15] Wholesale trade in all kinds of goods with a minimum capital for each store of less than THB100 million

[16] Advertising undertakings

[17] Hotel undertakings, except for hotel management services

[18] Tourism

[19] Sale of food or beverages

[20] Plant breeding and the propagation or plant improvement undertakings

[21] Doing other service businesses except for the service businesses prescribed in the Ministerial Regulations
VIETNAM
DISCLAIMER

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INTRODUCTION

Over the past 10 years, Vietnam has made numerous international commitments to liberalize its foreign investment regime, resulting in some dramatic changes to domestic law. In 2006, Vietnam introduced the Enterprise Law\(^1\) and the Investment Law\(^2\), partially motivated by its desired and subsequent accession to the World Trade Organization ("WTO").

Vietnam continues to attract foreign investment. Apart from foreign direct investment ("FDI"), foreign investors also achieve market access by way of mergers and acquisitions ("M&A"). Accordingly, it is paramount for investors to be cognizant of Vietnam’s international agreements and its continually evolving domestic laws and regulations.

There are four enterprises\(^3\) in Vietnam, which can be established, merged or acquired:

- The Single Member Limited Liability Company ("SM LLC")
- The Multi-Member Limited Liability Company ("MM LLC")
- The Joint-Stock Company ("JSC")
- The Public Joint Stock Company ("public company")

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1 Law No. 60/2005/QH11 on Enterprises adopted by the National Assembly on 29 November 2005, effective 1 July 2006, as amended by Law No. 38/2009/QH12 adopted by the National Assembly on 19 June 2009, effective 1 August 2009 ("Enterprise Law").

2 Law No. 59/2005/QH11 on Investment adopted by the National Assembly dated 29 November 2005, effective 1 July 2006 ("Investment Law").

3 Pursuant to the Enterprise Law, companies in Vietnam are referred to as "enterprises."
The acquisition of an enterprise can also take a number of different forms. There are four main techniques for acquiring a business in Vietnam:

- Through the purchase of shares
- Through the purchase of charter capital
- Through a merger or consolidation of a business
- Through an acquisition of assets
Regardless of the mode, some special considerations should be taken into account when acquiring an interest in an established enterprise in Vietnam.

**Purchase of Shares or Charter Capital**

The purchase of shares or equity is classified as either direct investment under the Investment Law or indirect investment under the Securities Law.

The purchase of shares or equity by an investor so that the investor can participate in the management of an enterprise is considered direct investment. Any purchase of shares that does not trigger participation in the management of the target enterprise is considered indirect investment.\(^1\) This can have a significant impact on the taxation of the transaction in certain circumstances.

It should be noted, however, that the distinction between indirect and direct investment is not well-drawn, as all the investors are typically accorded with certain rights to participate in the management of an enterprise corresponding to their equity holding ratio in such enterprise.

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\(^1\) Investment Law, Article 21.
Merger, Consolidation, Division and Separation

The Enterprise Law defines merger, consolidation, division and separation as follows:

- **Enterprise merger** is a process whereby one or a number of enterprises of the same type transfers all of its assets, legal rights, liabilities and benefits for the purpose of merging with another enterprise.²

- **Enterprise consolidation** is a process whereby two or more enterprises of the same type combine all of their assets, legal rights, liabilities and benefits for the purpose of consolidating among themselves so as to become a new enterprise.³

- **Enterprise division** is a division of all assets, legal rights, liabilities and benefits of an enterprise for the purpose of establishing two or more new enterprises.⁴

- **Enterprise separation** is a transfer of a part of the assets of an enterprise for the purpose of establishing one or more additional enterprises of the same type.⁵

All of these forms of restructuring enterprises take effect upon the approval of the relevant investment certificate issuing authority ("ICIA").

There are various rights and obligations that will cease to exist and others that are assumed by the parties involved after an enterprise reorganization.

After a merger is completed, the target enterprise will cease to exist and the surviving enterprise will assume the legal rights and interests of the target. Additionally the surviving enterprise is liable for the unpaid debts, labor contracts, property obligations and other liabilities of the target enterprise.⁶

In terms of consolidation, the consolidating enterprises will be extinguished upon completion and the new consolidated enterprise will assume the legal rights and interests, and is liable for the unpaid debts, labor contracts and other liabilities of the consolidating enterprises.⁷

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² Enterprise Law, Article 153.
³ Enterprise Law, Article 152.
⁴ Enterprise Law, Article 150.
⁵ Enterprise Law, Article 151.
⁶ Enterprise Law, Article 153.2(c).
⁷ Enterprise Law, Article 152.4.
In an enterprise division, the dividing enterprise will disappear and the newly established enterprises will be jointly liable for the unpaid debts, labor contracts and other liabilities of the dividing enterprise. However, the new enterprises may make agreements with the creditors, customers and workers in order for one of them to perform these obligations.  

In the case of enterprise separation, the separating enterprise and the separated enterprise will be jointly liable for the unpaid debts, labor contracts and other liabilities of the separating enterprise, except where the separating enterprise, the separated enterprise, and the creditors, customers and workers of the separating enterprise agree otherwise.

**Acquisition of Assets**

An onshore enterprise could also acquire some or all of the assets of another enterprise. For this purpose, the enterprise’s assets which may be acquired include the following:

- Shareholding, shares and other valuable papers
- Bonds, debts and other forms of borrowing
- Contractual rights, comprising rights, including trademarks, industrial designs, inventions, trade names, origin or appellations of origin of goods
- Rights with respect to real property, including the right to lease out, assign, mortgage and use to provide guarantees
- Items of revenue derived from investment activities, including profits and interest on shareholding, dividends, royalties and all types of fees
- Other assets and rights with economic value in accordance with law and international treaties of which Vietnam is a member

Additionally, investors in Vietnam are allowed to transfer investment projects within the country, and this process is regulated similarly to the transfer of capital from one enterprise to another. Decree No. 108 sets forth provisions requiring that the recipients of this transfer must first register as shareholders of the enterprise being transferred, and if the enterprise being transferred does not

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8 Enterprise Law, Article 150.3.
9 Enterprise Law, Article 151.3.
constitute the liquidation of the enterprise, the transfer of capital must be conducted in a way which complies with all regulations surrounding the transfer of capital.

**Competition Rules on Economic Concentration**

Under the Competition Law,\(^{11}\) enterprise mergers, consolidations, acquisitions and joint ventures are considered acts of economic concentration.

An economic concentration is prohibited if the combined market share of the enterprises participating in the economic concentration represents more than 50% of the relevant market, except in some exceptional cases. Where the enterprises participating in an economic concentration have a combined market share ranging from 30% -50% of the relevant market, the legal representative of those enterprises must notify the relevant competition administration authority.\(^{12}\) These enterprises can only proceed with the economic concentration after receiving the approval of the competition administration authority.\(^{13}\)

The Competition Law also provides limited exemptions for prohibited cases of economic concentration subject to conditions.\(^{14}\) Applicants for such exemption must submit a comprehensive application dossier to the competition administration authority prior to proceeding with any economic concentration activities.\(^{15}\)

**Domestic Versus Foreign Investment Considerations**

It is generally understood that it is easier to purchase an offshore entity with investment in a Vietnam-established enterprise than to purchase the latter directly onshore. This is largely due to the greater sophistication and clarity of most of the commonly used offshore jurisdictions.

However, it is important to note that, adjustments to the goal, location, form, capital and term of the project all require consent and approval of the Vietnamese partner[s] and ICIA.\(^{16}\) Tax implications related to the purchase of an offshore holding entity discussed under the Taxation section of this guide should also be noted.

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11 Law No. 27/2004/QH11 on Competition adopted by the National Assembly on 3 December 2004 ("Competition Law").
12 Competition Law, Article 20(1).
13 Competition Law, Article 24.
14 Competition Law, Article 19.
15 Competition Law, Article 29.
16 Investment Law, Article 51.
Right of First Refusal and Lock-ups

Any investor to an MM LLC has the right to sell or otherwise transfer its portion of charter capital. However, it must provide the remaining investors in the enterprise the first opportunity to obtain the charter capital under conditions and terms that are equal to or better than that which it would offer a third party. Only after the remaining investors in the MM LLC have each refused this opportunity may a third party be offered the charter capital.\(^1\)

In a JSC, within three years of the date the enterprise receives a certificate of business registration or an investment certificate, a founding shareholder has the right to freely transfer his or her common shares to another founding shareholder of the same enterprise and may only transfer his or her common shares to a third party if so approved in a general meeting of shareholders. In this case, the shareholder that intends to transfer his or her shares would not have the right to vote on such transfer of shares and the approved transferee automatically becomes a founding shareholder of the enterprise.\(^2\)

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1. Enterprise Law, Article 44.
2. Enterprise Law, Article 84(5).
Licensing

In general, and where the foreign investor is establishing a foreign-owned project in Vietnam, under the Investment Law and its implementing regulations, foreign investors must apply for an investment certificate with the ICIA. There are different licensing and registration steps depending on the size and nature of the investment projects:

**Investment Registration** - Projects whose investment capital is less than VND300 billion and that do not fall within conditional investment sectors will only be subject to investment registration. Obtaining an investment certificate by way of investment registration is meant to be simpler than obtaining an investment certificate by way of investment evaluation (see section below) and does not depend on the ICIA’s discretion. An investment certificate also serves as a certificate of business registration.

**Investment Evaluation** - Projects whose investment capital is VND300 billion or more, and/or projects that fall within conditional investment sectors will be subject to investment evaluation.

The size and nature of the investment project also determines which level of licensing authority will consider and approve that project.

**Conditional Investment Sectors for Foreign Investors**

The Investment Law does not, in and of itself, provide for a cap on foreign participation in Vietnamese enterprises (listed or unlisted) but rather, states that a foreign investor is entitled to contribute capital to, or purchase shares in an enterprise in Vietnam and that the government prescribes the proportion of capital contribution or share purchase of a foreign investor with respect to certain fields, industries and lines of business.

**Conditional Sectors**

The Investment Law lists conditional investment sectors for both Vietnamese and foreign investors. The conditional sectors of investment are rather broad and vague. These sectors include the following:

- Fields that have an impact on national defense or security, or social order or safety
- Financial and banking fields

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3 In 2012, USD1 is approximately VND21,000
• Fields that have an impact on public health
• Culture, information, the press and publications
• Entertainment services
• Real estate business
• Survey, search, exploration or exploitation of natural resources and the protection of the ecological environment
• Development of educational and training work
• A number of other fields under the provisions of law

Additionally, for foreign investors, the fields where investment is subject to conditions also include the fields where investment is made in accordance with the roadmap for implementing international commitments under the international treaties Vietnam has signed.

The Investment Law provides that, from time to time, the government will stipulate a list of fields where investment is subject to conditions, the conditions relating to the establishment of economic organizations, forms of investment and the opening of the market in certain fields for foreign investment. Specifically, Decree No. 108 provides a list of investment sectors which are conditional to foreign investors. These sectors include the following:

• Radio and television broadcasting
• Production, publication and distribution of cultural products
• Mineral tapping and processing
• Establishment of telecommunication network infrastructure, signal transmission and emission infrastructure, provision of Internet or telecommunication services
• Construction of a public postal network, provision of postal services or courier services
• Construction and operation of river ports, seaports, airports and air terminals
• Carriage of cargo and passengers by air, railways, overland roads, seas or

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4 Investment Law, Article 29(1).
5 Investment Law, Article 29(2)(5).
6 Investment Law, Article 29(5).
7 Decree No. 108/2006/ND-CP issued by the government on 22 September 2006, Appendix III “List of Conditional Investment Domains Applicable to Foreign Investors”.
inland waterways

- Catching sea produce
- Production of cigarettes
- Conducting real estate business
- Conducting import, export or distribution
- Education or training
- Hospitals or clinics
- Other fields of investment stipulated in international treaties Vietnam has signed committing to restrict the opening of the market to foreign investors

The conditions applicable to investments in these sectors are currently provided either in specialized laws governing the sectors in question or in the commitments made in international agreements or organizations of which Vietnam is a member, such as the WTO, which are generally commitments in terms of foreign participation in these sectors. Vietnam has generally interpreted these commitments as limitations.

In terms of procedure, under the Investment Law and Decree No. 108, applications for investment in conditional sectors are processed under a rigorous examination procedure, whereby opinions of high-level authorities will be required before the investment certificate is granted.

Public Companies

A public company is defined as a JSC that (i) has already conducted the public offering of its stocks; or (ii) has its stocks listed at a stock exchange; or (iii) has its stocks owned by at least 100 investors, excluding professional securities investors; and has a contributed charter capital of VND10 billion or more.

Decision No. 55\(^8\) provides that foreign investors are only able to buy up to 49% of all public shareholding companies, including both listed and unlisted public companies (or a cumulative total of 30% subject also to individual shareholding limits in the case of banks). Also, there are generally tender offer requirements triggered when an acquirer makes an offer that would lead to an ownership of 25% or more of a public company.

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\(^8\) Decision No. 55/2009/QD/Ttg on Percentage of Participation of Foreign Investors in Securities Market of Vietnam issued by the government on 15 April 2009 ("Decision No. 55").
The Law on Enterprise Income Tax ("EIT") and its implementing regulations apply a standard EIT rate and incentive policy to both domestic and foreign invested enterprises, while the Law on Personal Income Tax ("PIT") differentiates the tax treatment between resident and non-resident individuals.

Capital Gains Tax

If the acquisition is a straight purchase of the charter capital of the original investor, for example, in the case of an LLC, and consent from the Vietnamese party and approval from the ICIA is obtained, then EIT will be payable on any premium over the original investor’s actual contribution to capital or its cost to purchase the same. Such gains are taxed at a standard EIT rate of 25%.¹ This tax treatment is applicable to any transfer of the charter capital other than securities in an enterprise by foreign or local parties, without any exemption.

The transfer of securities (shares, investment fund certificates and bonds) by offshore institutional investors is subject to 0.1% EIT on the total value of securities sold on each transfer transaction. This is the deemed EIT regardless of whether the transfer results in a gain.

The profit gained by a resident individual upon the transfer of his or her capital contribution other than securities in a business enterprise is subject to PIT at the rate of 20% imposed on each transaction. If the transfer is in the form of a securities transaction, unless the individual investor follows the accounting regulations and registers to pay the PIT rate of 20% imposed on the profits gained, the PIT rate of 0.1% imposed on the total selling price will apply in each transaction.

A non-resident individual’s transfer of securities and capital contribution in business enterprises will be subject to a deemed PIT of 0.1% of the total proceeds from the transaction.

**Profits Remittance Tax**

Since 2004, the old profit remittance tax has been repealed. Capital gains that are repatriated or gains retained overseas on assignments which take place overseas are not subject to profits remittance tax.

**Transfer Taxes**

Vietnamese law provides that it is mandatory to register the ownership of certain types of property. Registry fees, known in Vietnamese as *le phi truoc ba*, are imposed on the purchaser of such property when it registers the ownership of the property.

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3 Decree No. 100/2008/ND/CP on Providing Guidelines for the Implementation of the PIT Law issued by the government on 8 September 2008, Article 17, as amended by Decree No. 106/2010/ND/CP on 28 October 2010 ("Decree No. 100").

This fee is only applicable to transfers in ownership of certain types of property, including vehicles, vessels, guns, buildings, houses and land.\(^5\)

Registry fees equal to 0.5% of the property value must be paid with respect to land and buildings, and different rates for the registry fees are applied for other items. However, in no case will the registry fees for one asset exceed VND500 million except for cars with less than 10 seats.\(^6\)

### Double Taxation Agreements

Vietnam has entered into a number of agreements on the avoidance of double taxation. There are 53 such agreements now in effect. A summary of these agreements is given in Appendix A. These agreements should also be taken into consideration when structuring cross-border acquisitions.

Vietnam’s agreements do not preclude Vietnam from imposing tax on capital gains realized by a foreign investor in certain instances. There are some exceptions to this general rule, mainly with respect to the alienation of aircrafts and ships. Double taxation agreements should, therefore, be considered for tax planning purposes.

The permanent establishment concept was introduced into Vietnamese EIT laws in 1999. The incorporation of this concept into Vietnamese tax law has been reinforced through subsequent amendments to the EIT laws during the past decade. As a result, double taxation agreements have been increasingly relevant to Vietnamese taxation. In this regard, the Ministry of Finance (“MOF”) issued a number of circulars that provide detailed guidelines on the application of double taxation agreements in Vietnam.

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5 Decree No. 176/ND/CP on Registration Fees issued by the government on 21 December 1999 (“Decree No. 176”), Article 1, replaced by Decree No. 45/2011/ND-CP issued on 17 June 2011.

Transfer of Employment

In the case where a foreign investor sells its charter capital in an MM LLC or SM LLC, there should be no change in the identity of the employer and it may be said that no legal transfer takes place merely by virtue of a change in the ownership of the employer. This is supported by the Labour Code,¹ which provides that in cases where an enterprise divides, separates, merges or transfers the ownership, management or right to use the assets of the enterprise, the new employer shall continue to be bound by the labor contract with the employee.

Special Considerations for Expatriates

Labor regulations impose requirements and restrictions on the recruitment and management of foreigners working in Vietnam.² Foreigners are required to have work permits to be employed in Vietnam, unless they are members of an MM LLC, owners of an SM LLC, members of the board of management of a JSC, or they are subject to certain other limited exemptions.³

² Decree No. 34/2008/ND/CP on Detailing and Guiding the Implementation of a Number of Articles of the Labour Code Regarding the Employment and Management of Foreign Labourers issued by the government on 25 March 2008 (“Decree No. 34”), as amended by Decree No. 46/2011/ND/CP on 17 June 2011 (“Decree No. 46”).
³ Decree No. 34, Article 9.1.
The appropriate authorities must be notified of these exempt workers at least seven days prior to the commencement of work. A work permit is valid for a period of time no longer than the term provided in the labor contract, and is to be signed between the local enterprise and expatriate, in either the assignment letter that the foreign enterprise sends the expatriate, the contract in which the expatriate enters Vietnam to perform, or in the terms of the operation license for a foreign non-governmental organization in Vietnam.

Under current law, the term of a work permit for an expatriate does not exceed three years. Under the new Labor Code which takes effect on 1 May 2013, the term of the work permit can not exceed two years.

As the law requires the new employer to be bound by the current labor contracts, the new employer is responsible for renewing the work permits or applying for new work permits for its expatriate workers. The application for work permit extension must be accompanied by a training contract signed between the employer and a Vietnamese citizen who will be trained to replace the foreigner, or a training plan to train Vietnamese citizens to replace foreigners.

A sale of an enterprise by means of a transfer of its charter capital or sale of shares would not normally constitute a change in the identity of the employer in its labor contract and the work permit would remain unchanged. However, a merger terminates the existence of the merging enterprise and thereby changes the "employer" in the merging enterprise's existing labor contracts. The new employer becomes the merged enterprise. Similarly, a consolidation terminates the existence of the consolidating enterprise, and changes the "employer" in the existing labor contracts.

Role of Union and the Local Labor Authorities

Except for the approval of the ICIA, the law does not require the transferor to obtain the consent of a local labor authority or the union before the sale of an enterprise, nor does it require the transferor to give prior notice to the labor authority. This is, however, not the case if there are any layoffs resulting from the sale.

In cases where the sale results in employee layoffs, the law requires that the transferor (or the transferee if the layoffs happen after the sale) to go through a different set of procedures and formalities which include union consultation and labor authority notification. Moreover, the ICIA may consult the local labor authorities if it feels it would be necessary or appropriate to do so under the circumstances.

4 Decree No. 34, Article 9.4.
5 Under the implementing regulations of Decree No. 34, as amended by Decree No. 46.
Notice Requirements

The Labour Code requires that in cases where the employer unilaterally terminates a labor contract, the employer must give notice to the employee at least 45 working days prior to the date of termination of such contract with unspecified duration. Notice of 30 working days is required with respect to a contract with a specified duration of one to three years, and three days’ notice is required with respect to a contract for seasonal work or fixed tasks. Employers are allowed to pay an equivalent amount of salary in lieu of notice.  

In some circumstances, the employer must discuss and reach an agreement with the executive committee of the labor union of the enterprise and report to relevant labor authorities. It is generally very difficult for employers to unilaterally terminate labor contracts with employees because it must satisfy certain conditions regulated by laws; however, an enterprise ceasing to exist (for example, due to merger, acquisition, dissolution or consolidation) is a legal basis to unilaterally terminate employees.

Severance Payment

Upon the termination of a labor contract, including unilateral termination, the employer must pay an employee who has worked for the enterprise for at least 12 months an amount equal to one-half month’s salary for each year that he or she has worked in the enterprise. Workers who have less than a year of service are not eligible for severance payment. In the case of disciplinary terminations, severance payments are forfeited.

In the case of layoffs due to the restructuring of an enterprise or changing technology, the employer is required to pay employees who have worked for at least 12 months an amount equal to one month’s salary for each year such employees worked for the enterprise, but not less than two months’ salary. Employees who are subject to labor contract termination following corporate merger, consolidation, separation or splitting, transfer of the right to own, manage or use assets of enterprises, are also entitled to the same allowances.

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6 Labour Code, Article 38.
7 Labour Code, Article 42(1).
8 Labour Code, Article 17
Employers having 10 employees or more, and Vietnamese employees working under labor contracts with a term of 12 months or more for such employers will be subject to the unemployment insurance regulations. Employees contribute 1% of their salary capped at 20 times the general minimum wage, and employers and the State each contribute an amount equivalent to 1% of the total payroll used to contribute to social insurance of employees participating in the unemployment insurance fund.

If an employee terminates a labor contract or loses his or her job after 1 January 2009, he or she will receive a severance allowance or job loss allowance from the employer for the duration of service before, and enjoy unemployment benefits provided by the social insurance fund for the duration of service that he or she participated in the unemployment insurance scheme beginning 1 January 2009.¹⁰

That means after the effective date of unemployment insurance, the severance allowance for the employee’s duration of service before 2009 will still be carried forward to the termination of labor contracts, but the employer will not have to pay severance allowance for the employee’s duration of service in which employees and employers make the contribution to unemployment insurance fund after 1 January 2009.

¹⁰ Decree No. 127/2008/ND-CP Detailing and guiding the implementation of a number of articles of the social insurance Law concerning unemployment insurance issued by the government on 12 December 2008.
Standards of due diligence among foreign investors acquiring existing MM LLCs, SM LLCs and JSCs vary tremendously.

Some take the view that the representations and warranties of the seller are sufficient to provide recourse in the event that the acquired enterprise later turns out to suffer from fundamental problems that were not revealed during the negotiations. Others, especially enterprises listed on foreign stock exchanges, are obliged to examine the assets they are acquiring very closely before they commit their shareholder’s equity.

The following discussion will focus on some of the special considerations that usually arise in the due diligence process for those who take a more conservative approach.

**Entrepreneurial Enterprises**

Many of the projects that were developed by entrepreneurial foreign investors that first came to Vietnam suffer from poor documentation and structuring. Likewise, an entrepreneurial Vietnamese enterprise also may not always be well organized. Insufficient budgets, not accessing international-standard professional services, and general inexperience toward corporate governance and compliance, not to mention an evolving regulatory framework, typically result in contracts and charters (the equivalent of articles of association in Vietnam) which, may not always qualify as bankable.
In most cases, these documents were based on simple government-supplied guidance forms, which project developers copied without much consideration for the specific needs and circumstances of their own businesses.

Thus, any change in the foreign investor of a project usually involves some element of financing, re-drafting or supplementing the original documentation into a form that is acceptable not just to the new foreign investor but also to creditors.

**Memorandum of Understanding/Letter of Intent**

A preliminary agreement such as a memorandum of understanding ("MOU") or a letter of intent ("LOI") is not a legal prerequisite to a merger or acquisition in Vietnam but it can be a useful tool for reaching an initial "meeting of the minds" between the parties concerned. Given the unique nature of Vietnam’s legal system and some of its common business practices, both sides may be surprised by some of the assumptions and expectations of the other, and an MOU or an LOI can flush these out for resolution at an early stage.

**Due Diligence**

Due diligence faces special challenges in Vietnam where there is commonly a lack of transparency among enterprises throughout the country. Furthermore, State secrecy laws may be invoked in cases where the due diligence target has State ownership. Moreover, record-keeping and accounting practices are not what investors may find in other business environments, making the task of verifying a target enterprise’s compliance status even more difficult. Patience, diplomacy and good communication skills are necessary for obtaining necessary information about a target enterprise.

Furthermore, many target enterprises in Vietnam are unfamiliar with which documents need to be provided or disclosed in the due diligence process, or how to properly organize them for the due diligence teams. This can affect the accuracy of a due diligence process and cause some significant work delays, which must be budgeted for.
Representations and Warranties

Representations and warranties are a recent practice for Vietnamese business people, so many local partners, for example, will resist their inclusion in any acquisition documents. However, given the unique and relatively untested legal framework for such transactions, it is even more important that the parties clearly define their respective rights and liabilities. Moreover, given the highly regulated business environment and heavy statutory liabilities in selected areas (e.g., environmental), detailed representations and warranties are highly advisable.

Closing

Closing logistics vary depending on the nature of the target. Notarization and legalization will be required for some certain documents issued by foreign authorities to foreign investors (e.g., a certificate of incorporation of a foreign investor and audited financial statements). Furthermore, amended licensing documents are required from the relevant authorities. In nearly all cases, it is important to be patient and expect that the paperwork will be a time-consuming process.
Acquisitions of interests in Vietnamese enterprises are becoming more common as the foreign direct investment environment in Vietnam matures. Attention should be paid to the unique characteristics of acquiring an interest in a Vietnamese enterprise (LLC or JSC), whether directly or indirectly, to make sure that the acquisition achieves the goal of bringing a project to fruition.
### APPENDIX A – VIETNAM’S DOUBLE TAXATION AGREEMENTS

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<td>Tijuana</td>
<td>Baker &amp; McKenzie Abogados, S.C.</td>
<td>+52 664 633 4300</td>
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<td>Baker &amp; McKenzie Maroc</td>
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