

CHAPTER 10

SHARE PURCHASE OVERVIEW

[10-1] The sale and purchase of shares is the most common form of corporate acquisition in Hong Kong. By acquiring part or all of the share capital of a target company, the investor can exercise control over the target company as well as its businesses and assets. Many parties tend to opt for sale of shares over sale of assets in corporate acquisitions because share acquisitions are generally simpler and more straightforward. The subject of the transaction is the shares in the target company.

[10-2] The other form of corporate acquisition is through the sale and purchase of the target company's asset. To do this however, the buyer has to identify and then acquire ownership of each asset to be sold and assigned. The asset sale transaction structure and procedures are often more complex. Transfer of assets may also trigger the application of the Transfer of Businesses (Protection of Creditors) Ordinance (Cap 49), which requires the publication of gazette and newspaper notices of transfer and affects the timing of completion of the asset sale transaction.

1. LEGAL ISSUES

[10-3] The following are some common legal issues that the parties should consider when structuring a share acquisition.

1.1 Ownership of shares

[10-4] The buyer should ascertain that the selling shareholder has the sole legal and beneficial ownership over the sale shares and ensure that the seller can validly transfer and the buyer can effectively acquire the full rights and powers under the sale shares without third-party encumbrances or consent.

1.2 Shareholder loans

[10-5] If the selling shareholder has extended shareholder loans to the target company, the buyer should acquire the shareholder loans together with the sale shares to avoid situations where the target company remains indebted to its old shareholder after the new shareholder has taken over the target company. The pricing of the acquisition should include both the sale of the shares and the sale and assignment of the shareholder loans, if any.

1.3 Restrictions on share transfers and pre-emptive rights

[10-6] The articles of association of private Hong Kong companies must contain restrictions on the right to transfer shares. The restrictions may comprise pre-emptive rights or may require approval from the board of directors to effect the transfer. If the target company has more than one shareholder, the buyer should check whether there are existing shareholder agreements which may stipulate similar restrictions that are binding on the selling shareholder.

1.4 Third party consent

[10-7] Sometimes the selling shareholder or the target company may have entered into agreements with third parties such as loan agreements with banks, which contain change of control provisions to disallow any transfer of shares in the target company without their prior consent. Furthermore, the relevant statutory requirements relating to change of control will need to be complied with if the target company operates in a regulated industry such as financial institutions and insurance companies. This will impact the complexity and timing of the transaction.

1.5 Source of funds and financial assistance¹

[10-8] The buyer should consider from where its source of funds for the acquisition will come. Hong Kong companies are generally prohibited under the Companies Ordinance (Cap 622) (CO) from giving financial assistance for the acquisition of their own shares. As such, the target company cannot provide any financial assistance to the buyer for purchasing its shares. In addition, the meaning of financial assistance is rather broad as it includes, but is not limited to: assistance given by way of gift; guarantee, security or indemnity; release or waiver; loan, novation or assignment of a loan; or any act by which the company's net assets are reduced to a material extent or by a company with no net assets.² In brief, there must be some kind of 'assistance' and that assistance must be of a 'financial' nature.³

[10-9] The prohibition is somewhat relaxed in respect of Hong Kong private and public companies provided that certain conditions are met and ss 277 to 282 of the CO largely retain the exceptions to the prohibition. Section 277 of the CO provides the general exceptions from the prohibition as follows:

- (a) the distribution of a company's assets by way of dividend lawfully made;
- (b) the distribution of a company's assets made in the course of winding up;

1 See Chapter 25, Financial Assistance.

2 See s 274(1) of the CO.

3 *MT Realisations Ltd v Digital Equipment Co Ltd* [2003] EWCA Civ 494; *British and Commonwealth Holdings plc v Barclays Bank plc* [1996] 1 BCLC 1.

- (c) the allotment of bonus shares;
- (d) the reduction of the company's share capital in accordance with Division 3 of Part 5 of the CO;
- (e) the redemption or buy-back of the company's shares made in accordance with Division 4 of Part 5 of the CO;
- (f) anything done in accordance with a court order under Division 2 of Part 13 of the CO;
- (g) anything done under an arrangement made in pursuance of s 237 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) (**C(WUMP)O**); and
- (h) anything done under an arrangement made between a company and its creditors under s 254 of C(WUMP)O.

[10-10] Moreover, ss 279 to 281 provide for the following exceptions from the prohibition:

- (a) where money-lending being part of the company's ordinary business, the lending of money in the ordinary course of business;
- (b) the giving of financial assistance in good faith in the interests of the company for the purpose of an employee share scheme; and
- (c) the making of loans to the company's eligible employees to acquire fully paid shares in the company.

[10-11] The exceptions under ss 279 to 281 of the CO also apply to listed companies if the company has net assets that are not reduced by the giving of the financial assistance or (to the extent that those assets are reduced) the assistance is provided by a payment out of distributable profits.⁴

[10-12] Nevertheless, under s 278 of the CO, the giving of financial assistance is also permitted if:

- (a) the company's principal purpose in giving the assistance is not for the purpose of the acquisition of its shares or for the reduction or discharge of its liability incurred for such an acquisition, or that is only an incidental part of some large purpose of the company; and
- (b) the assistance is given in good faith in the interests of the company.

1.6 Competition law⁵

[10-13] In the past, Hong Kong did not have a generic anti-competition law regime. The competition laws were only applicable to the telecommunications and broadcasting industries. In June 2012, the Legislative Council of Hong Kong enacted the Competition Ordinance (Cap 619) (**Competition Ordinance**) which came into effect on 14 December 2015. This created an anti-competition regime to prohibit acquisitions and mergers that would substantially lessen competition in Hong Kong. The buyer will need to review this new piece of legislation in structuring transactions.

⁴ See s 282 of the CO.

⁵ See Chapter 26, Competition Law Issues.

1.7 Taxation

[10-14] Transfers of Hong Kong stock, including shares, are subject to Hong Kong stamp duty.⁶ The rate of stamp duty is 0.1% of the amount of the consideration or of its value on every sold note and every bought note and HK\$5 on an instrument of transfer (under Head 2(1) and 2(4) of Schedule 1 of the Stamp Duty Ordinance (Cap 117) (SDO)).⁷ It is common for the buyer and the seller to each share 50% of the total stamp duty in a share sale transaction. Subject to payment of an adjudication fee, which is currently HK\$50, anyone can request the Collector of Stamp Revenue to express his opinion on whether an executed instrument is chargeable with stamp duty and the amount payable.⁸

[10-15] Hong Kong does not have any capital gains tax regime that is chargeable on the disposal of shares or assets.

2. STEPS AND DOCUMENTATION

2.1 Pre-contractual agreements

[10-16] At the initial stage of negotiation, the parties often record their key understandings in a heads of terms (also called a letter of intent or a term sheet), which is usually subject to contract but non-binding except for certain provisions such as confidentiality, exclusivity and non-solicitation. The heads of terms sets a platform for negotiation of the definitive transaction documents pending due diligence. To protect their respective interests in the negotiation and due diligence stage, the parties can separately enter into confidentiality, exclusivity and non-solicitation agreements. The parties can agree to the payment of a break fee⁹ should one decide not to proceed with the transaction.

2.2 Due diligence¹⁰

[10-17] Through legal and financial due diligence, the buyer can obtain information about the seller, the sale shares, the target company and its business and assets for the purposes of assessing the benefits and risks associated with the acquisition, valuation and negotiation of definitive transaction documents. The results of the due diligence will be reported to the buyer by its professional advisers. The buyer should engage foreign experts if the target company carries on businesses or owns assets in another jurisdiction.

[10-18] For legal due diligence, the types of information to be gathered generally include the ownership of shares, the target company's business, assets and financial information, material contractual commitments, employment issues, contingent liabilities, foreign corrupt payment and regulatory and compliance

6 See Chapter 28, Stamp Duty Issues.

7 See ss 19(1)(b), 4(1) and Schedule 1 of the SDO.

8 See the Fifth Schedule of the SDO for adjudication fee.

9 See Chapter 14, Break Fees.

10 See Chapter 15, Due Diligence.

CHAPTER 29

PUBLIC MERGERS AND ACQUISITIONS IN HONG KONG

1. PRINCIPAL WAYS OF OBTAINING CONTROL OF A PUBLIC LISTED COMPANY IN HONG KONG

[29-1] In Hong Kong, contractual general offer and scheme of arrangement are the main methods to acquire control of a publicly listed company.

1.1 Contractual general offer

[29-2] This is the common structure to effect a takeover of a public listed company in Hong Kong whereby a general offer is made by a bidder to acquire all the issued share capital of the target from its existing shareholders. The conduct of public M&A in Hong Kong is governed by The Codes on Takeovers and Mergers and Share Buy-backs (the **Takeovers Code**).

[29-3] A takeover offer can be voluntary or mandatory. In a voluntary offer, a bidder makes an offer to acquire the shares in a public listed company and such offer can either be friendly, eg recommended by the target's board, or hostile. When an individual's shareholding in a public listed company reaches certain control triggers, the requirement under the Takeovers Code to make a mandatory offer would arise.

1.2 Scheme of arrangement

[29-4] This structure is a court-sanctioned scheme of arrangement under the CO whereby a Hong Kong court can sanction proposed arrangements between a company and its shareholders. The usual procedure involves a bidder making a proposal to cancel all the shares in the target, except those owned by the bidder, in return for cash or non-cash consideration from the bidder, followed by a de-listing of the target's shares.

2. OVERVIEW OF LEGAL FRAMEWORK FOR PUBLIC M&A

[29-5] Public M&A in Hong Kong are subject to the regulations below.

2.1 The codes on takeovers and mergers and share buy-backs

[29-6] The Takeovers Code was issued by the Securities and Future Commission (SFC) and forms a key framework to regulate any takeover, merger, privatisation and share repurchase activities affecting public companies in Hong Kong. The statute's purpose is to ensure fair and equal treatment of shareholders. Although the Takeovers Code does not have the force of law, anyone in breach of the Takeovers Code may be subject to the SFC's private reprimand, public censure, and issuance of a public statement which involves criticism, disciplinary action or suspension.

[29-7] The Takeovers Code applies to the following companies:

- (a) public companies in Hong Kong;
- (b) companies with a primary listing of their security on The Stock Exchange of Hong Kong Limited (the **Hong Kong Stock Exchange**); and
- (c) real estate investment trusts with a primary listing of their units on the Hong Kong Stock Exchange.

2.2 The rules governing the listing of securities on the Stock Exchange of Hong Kong Limited (Listing Rules)

[29-8] The Listing Rules were issued and is under regular review by the Hong Kong Stock Exchange. It aims to govern the obligations of companies listed on the Hong Kong Stock Exchange and ensure that investors have and can maintain confidence in the Hong Kong stock market. The Listing Rules contain certain provisions on, inter alia, acquisition of a company listed on the Hong Kong Stock Exchange, delisting from the Hong Kong Stock Exchange, as well as regulating the disclosure and shareholder approval requirements for transactions contemplated by the listed companies.

2.3 The CO

[29-9] The CO applies to all companies incorporated in Hong Kong and contains statutory provisions governing schemes of arrangements and compulsory acquisitions. For companies incorporated in jurisdictions outside Hong Kong, the relevant local company law will apply.