

THE MERGERS &
ACQUISITIONS
REVIEW

ELEVENTH EDITION

Editor
Mark Zerdin

THE LAWREVIEWS

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MERGERS &
ACQUISITIONS
REVIEW

The Mergers and Acquisitions Review

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HONG KONG

*Jason Webber*¹

I OVERVIEW OF M&A ACTIVITY²

M&A activity in Hong Kong dropped in 2016 in terms of total deal value and number of deals. Hong Kong saw a 56.08 per cent decrease in the value of M&A deals announced in 2016 compared to 2015, with a total of 599 announced deals in 2016, out of which 516 deals had a total disclosed value of US\$118.12 billion compared with a total of 636 announced deals in 2015, out of which 563 deals had a total disclosed value of US\$268.94 billion. Similarly, there were 469 M&A deals completed in 2016, out of which 394 deals had a total disclosed value of US\$125.07 billion, a drop of 39.66 per cent compared to the 537 M&A deals completed in 2015, out of which 472 deals had a total disclosed value of US\$207.26 billion.³

The Hong Kong securities markets showed a slight increase in terms of market capitalisation but a notable decrease in terms of trading activity in 2016. The total market capitalisation of the securities market at the end of 2016 was HK\$24,761.3 billion, 0.31 per cent higher than the year-end total market capitalisation in 2015. Total securities market turnover in 2016 was HK\$16,396.4 billion, a drop of 37.16 per cent compared with 2015. A total of 126 companies were newly listed on The Stock Exchange of Hong Kong Limited (SEHK) in 2016, and the total amount of equity funds raised on the SEHK in 2016 was approximately HK\$490.05 billion.⁴

During 2016 as a whole, Hong Kong's economy grew by 1.9 per cent, less than the 2.4 per cent growth in 2015 and the average annual growth rate of 2.9 per cent over the previous decade. The government has forecast that the Hong Kong economy will grow by 2 to 3 per cent in 2017.⁵

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

The law governing mergers and acquisitions in Hong Kong comprises primary legislation, regulatory rules, the law of contract and case law.

1 Jason Webber is a partner at Slaughter and May. The author would like to thank Nicola Lui and Karen Lee for their assistance in preparing this chapter.

2 Statistics on mergers and acquisitions involving Hong Kong companies differ significantly among various sources. This summary covers all Hong Kong M&A activity from 1 January 2016 to 31 December 2016.

3 Source: Mergermarket. The statistics shown include majority stake deals (over 30 per cent) only and exclude lapsed or withdrawn bids.

4 Source: SEHK Fact Book 2016.

5 Source: 2016 Economic Background and 2017 Prospects, Financial Secretary's Office Government of the HKSAR (www.hkeconomy.gov.hk/en/pdf/er_16q4.pdf).

The primary legislation that applies principally to Hong Kong-incorporated companies in general is the Companies Ordinance (CO), and includes provisions relating to financial assistance for the acquisition of a company's own shares, merger relief, transfers of shares and schemes of arrangement affecting mergers. The Securities and Futures Ordinance (SFO) is also relevant, covering the regulation of offers of securities, and the communication of invitations and inducements to engage in securities transactions. For companies in certain industries, there is also specific legislation that may be relevant, for example:

- a* the Banking Ordinance for banking, restricted licence banking and deposit-taking companies;
- b* the SFO for securities, financial advisory and asset management companies;
- c* the Broadcasting Ordinance (BO) and the Telecommunications Ordinance (TO) for radio, television broadcasting and telecommunications companies; and
- d* the Insurance Companies Ordinance for insurance companies.

Prior approval of ownership changes from the relevant regulatory bodies may be required under the legislation listed above.

If an M&A transaction involves a company whose shares are listed on the SEHK, the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (Listing Rules) will also apply. In addition, the Securities and Futures Commission (SFC), in consultation with the Takeovers and Mergers Panel (Panel) – a committee formed by the SFC pursuant to the SFO – has issued the Code on Takeovers and Mergers (Takeovers Code), which applies to takeovers, mergers and share buy-backs affecting public companies⁶ in Hong Kong and companies with a primary listing of their equity securities in Hong Kong. The Takeovers Code is not statutory and does not have the force of law, but the Listing Rules expressly require compliance with the Takeovers Code. As a non-governmental statutory body, the SFC regulates the securities and futures markets in Hong Kong and oversees the development of these markets. Its decisions apply to M&A of public companies.

Since Hong Kong is a common law jurisdiction,⁷ the law of contract (which is largely derived from English law) and case law⁸ also form an important part of the law governing M&A in Hong Kong.

6 The Takeovers Code states that all circumstances are to be considered, and an economic or commercial test is to be applied (taking into account primarily the number of Hong Kong shareholders and the extent of share trading in Hong Kong), in deciding whether a company is a 'public company'. For the purposes of the CO, a private company is a company incorporated in Hong Kong that, by its articles of association, restricts the right to transfer its shares; limits the number of its members to 50, not including persons who are in the employment of the company and persons who, having been formerly in the employment of the company, were, while in that employment, and have continued after the termination of that employment to be, members of the company; and prohibits any invitation to the public to subscribe for any shares or debentures of the company (Section 11 of the CO).

7 Under the 'one country, two systems' approach, implemented after the transfer of sovereignty over Hong Kong to the People's Republic of China (China) on 1 July 1997, Hong Kong remains a common law jurisdiction.

8 English case law has persuasive authority only and is subject to interpretation by the Hong Kong courts.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Takeovers Code

To ensure that the Takeovers Code takes account of market developments and developing international practice, it is kept under regular review by the Executive of the SFC, in consultation with the Panel. There have been no significant recent amendments to the Takeovers Code.

ii Listing Rules

The Listing Rules reflect currently acceptable standards in the marketplace and are designed to ensure that investors have, and can maintain, confidence in the market. To ensure that the Listing Rules take account of market developments and developing international practice, the SEHK regularly reviews the Listing Rules and may, subject to the approval of the SFC under Section 24 of the SFO, make amendments to the Listing Rules.

Certain amendments were made recently to the Environmental, Social and Governance Reporting Guide (ESG Guide) and related Listing Rules. The upgrading of general disclosures under each aspect of the ESG Guide regarding 'comply or explain' provisions, the inclusion of a disclosure of gender diversity as a recommended disclosure and the related Listing Rules amendments came into effect for issuers' financial years commencing on or after 1 January 2016. The upgrading of key performance indicators in the environmental area of the ESG Guide from recommended disclosures to 'comply or explain' provisions came into effect for issuers' financial years commencing on or after 1 January 2017.

iii The Companies Ordinance

The Companies Ordinance came into effect on 3 March 2014. Various key concepts under the Companies Ordinance that are relevant in the context of M&A are set out below:

- a* the requirements for approving a scheme of arrangement differ depending on the type of scheme. For privatisation schemes and members' schemes involving a takeover offer or a general offer, the 'disinterested shares test' (which requires 'not more than 10 per cent of the total voting rights attached to all disinterested shares [to be] voted against the proposal') applies so as to align with the requirement under the Takeovers Code in the context of a takeover. The headcount test (which requires that a majority of the shareholders of the 'target' company voting on a scheme of arrangement (either in person or by proxy) must vote in favour of it) applies to creditors' schemes and members' schemes not involving a takeover offer or a general offer, and in these situations, the court is given discretion to dispense with the test in appropriate circumstances;
- b* a company and its wholly owned subsidiaries may amalgamate and continue as one company without the sanction of the court, provided that certain conditions are met. Such conditions include, for example, that each amalgamating company is a Hong Kong incorporated company limited by shares, that each amalgamating company is solvent and that no creditor of an amalgamating company will be prejudiced by the amalgamation;
- c* there is a general prohibition on both private and public companies providing financial assistance for an acquisition of shares in itself, and streamlined 'whitewash' procedures are extended to listed companies. In addition, it is expressly provided that a company

is not prohibited from giving financial assistance for the purpose of an acquisition of shares in its holding company if the holding company is incorporated outside Hong Kong; and

- d* companies now enjoy more flexibility in structuring and organising their share capital in light of the updating of certain concepts relating to share capital (par value (or nominal value), share premium and the requirement for authorised capital have been abolished). Despite the absence of share premium, merger relief continues to be available. The amount required to be recorded as share capital in respect of the consideration shares issued by an acquiring company is the subscribed capital attributable to the acquired shares.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

Given Hong Kong's position as a hub for investment into China, its status as a major regional financial centre, and the widespread use of offshore companies for investment into and out of China, a substantial number of transactions have foreign involvement, including in the form of acquisitions by offshore companies. An analysis by reference to foreign involvement in transactions is therefore not particularly meaningful.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

As a significant number of companies whose shares are listed on the SEHK have controlling shareholders, there is not a large number of unsolicited M&A offers.

There were numerous high-profile M&A transactions in 2016. In June 2016, a consortium led by Tencent Holdings Limited, which is listed on the SEHK, agreed to acquire a 84.3 per cent stake in Supercell Oy from SoftBank Group Corp for approximately US\$8.6 billion. Supercell Oy is a Finnish company that develops mobile games for tablets and smartphones and that created several popular games in the market, including Clash of Clans. It is expected that this acquisition would enable Tencent to enhance its research and development capabilities and boost its revenue in, and access to, the global mobile gaming market. Earlier in March 2016, China Overseas Land and Investment Limited, which is listed on the SEHK, agreed to acquire CITIC Real Estate Group Co, Ltd and the residential property assets of CITIC Pacific Limited in China from CITIC Limited for approximately 31 billion yuan, including certain real estate assets held by China Overseas Land and Investment Limited, subject to adjustment. The CITIC property portfolio that was the subject of this transaction spanned across 25 cities in China with a total gross floor area of approximately 31.55 million square metres as at 30 April 2016.⁹ The acquisition represents a notable consolidation between two large real estate developers in China and continues the trend of business restructuring by conglomerates seen in 2015.

Another trend seen in 2016 was the increased number of privatisations of undervalued companies that were listed on the SEHK. Certain Chinese-based SEHK listed companies sought to privatise in favour of possible re-listing in Mainland China. Dalian Wanda Group Co, Ltd privatised Dalian Wanda Commercial Properties Co, Ltd (Dalian Wanda Commercial), a leading commercial property developer in China, with an intention to re-list

⁹ Announcement issued by China Overseas Land & Investment Limited dated 29 June 2016.

in Mainland China. The privatisation was structured as a voluntary conditional general offer for Dalian Wanda Commercial's Hong Kong listed H shares. Dalian Wanda Commercial was delisted from the SEHK in September 2016 and is currently a listing applicant for listing on the Shanghai Stock Exchange. Similarly, low trading volume and depressed share price were largely regarded by the market as the primary reasons behind the privatisation and delisting from the SEHK of Peak Sport Products Co, Limited, one of China's largest branded sports goods companies. However, the privatisation of SEHK listed companies is a complicated process.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

In common with many other jurisdictions, Hong Kong's Takeovers Code requires an offeror to have certainty of funds to make an offer for a public company. Under the Takeovers Code, in an announcement of a firm intention to make an offer, that announcement should include a confirmation by a financial adviser (or another appropriate third party) that resources are available to the offeror sufficient to satisfy full acceptance of the offer (a sufficiency statement). Such confirmation is not only required when the consideration is cash, or includes an element of cash, but is also required when the consideration consists of, or includes, any other assets except new securities to be issued by the offeror. The executive may also require evidence to support the sufficiency statement, and evidence that the offeror has sufficient resources to complete the purchase of shares that gives rise to the offer obligation.

Depending on how the acquisition is structured, M&A transactions in Hong Kong are usually financed by:

- a* internal resources;
- b* shareholders' loans;
- c* equity issues;
- d* debt issues;
- e* loan facilities from banks and financial institutions; or
- f* a combination of two or more of the above.

VII PENSIONS AND EMPLOYMENT LAW

Under Hong Kong law, there is no specific regulation that provides for the transfer of employment contracts when there is a change of ownership of a business, as opposed to an employing company. Employment contracts would therefore be terminated in the case of an acquisition of a business, and the new employer would have the freedom to decide whether to enter into new employment contracts with existing employees. However, generally speaking, where termination of an employment contract takes place due to a transfer of business, this would constitute redundancy, and employees previously employed may be entitled to severance payments and long-service awards, for which the old employer would be liable. However, under Sections 31J and 31C of the Employment Ordinance (EO), severance payments and long-service awards are not payable in the case of a business transfer if, not less than seven days before the end date of an employee's previous contract, the new employer has offered to renew that employee's contract, or to re-engage him or her under a new contract, on no less favourable terms and conditions, and the employee has unreasonably refused that offer. If an offer of renewal or re-engagement is accepted by the employee, the new contract has effect as if the renewal or re-engagement had been a renewal or re-engagement

by the old employer without any substitution of the new employer,¹⁰ and, therefore, the employment relationship will be regarded as being ‘continuous’ for the purposes of the EO.¹¹ Any redundancy issues that may arise in future disposals of the business would therefore be passed to the new employer after the renewal or re-engagement.

Generally speaking, under the Mandatory Provident Funds Schemes Ordinance (MPFO), an employer¹² must enrol its employees as members of one of the registered MPF schemes (as defined in the MPFO) available in the market in Hong Kong. An employer may enrol different employees in different registered schemes. During the contribution period (as defined in the MPFO), the employer must contribute to the registered scheme from its own funds an amount determined in accordance with the MPFO, and deduct from the employee’s relevant income for that period as a contribution by the employee to the scheme a further amount determined in accordance with the MPFO. Employees and employers may make additional voluntary contributions to the employee’s scheme.

Where there is a proposed disposal of a business, the existing employer and the proposed new employer should consider the implications of the MPFO and arrangements to deal with the accrued benefits of employees under the applicable MPF scheme. If a merger or acquisition is to be effected by way of a share sale, it is not likely that there will be any MPF implications (unless the relevant target company is spun out from a group of companies that operates a group-based scheme), as the merger or acquisition will not involve a change of employer. The surviving party or acquirer would nevertheless be well advised to carry out due diligence to ensure that all target employees are employed by the target company on terms that comply with the MPFO.

However, if the merger or acquisition is to be effected by way of a business transfer involving a change of employer, the employee must, in accordance with Section 14 of the MPFO, elect to transfer the accrued benefits to a contribution account¹³ under the new employer’s MPF scheme; retain the accrued benefits in the previous MPF scheme under a preserved account;¹⁴ or transfer the accrued benefits to a preserved account of another MPF scheme.

Both the seller and the buyer must observe and comply with the requirements of the MPFO with respect to the transfer of the accrued benefits of employees.

On 1 May 2011, the Minimum Wage Ordinance came into effect in Hong Kong and introduced a statutory minimum wage.

VIII TAX LAW

Hong Kong’s competitive economy is reflected in the transparency, predictability and simplicity of its low-rate tax system. These attractive qualities mean that, unlike many other jurisdictions, Hong Kong tax is generally not the determining factor in the way in which a

10 Section 31J of the EO.

11 Subsection 3 of Section 31J of the EO and Paragraph 5 of Schedule 1 of the EO.

12 Under the MPFO, an ‘employer’ means any person who has entered into a contract of employment to employ another person as his or her employee.

13 A contribution account is an account mainly used to accumulate MPF contributions in respect of current employment and investment returns.

14 A preserved account is an account in which accrued MPF benefits in respect of former employment are held.

transaction is structured in Hong Kong. There is no capital gains tax on the disposal of assets, including the disposal of shares and property. In addition, dividends are not classified as taxable income, and there is no withholding tax on dividends.

Stamp duty on the transfer of Hong Kong shares is currently 0.2 per cent of the consideration paid (or market value), and is generally payable in equal shares of 0.1 per cent by both the seller and the buyer. Transactions that are structured as schemes of arrangement do not attract stamp duty. With effect from 23 February 2013, stamp duty on the transfer of immovable property in Hong Kong ranges from 1.5 per cent (for transactions up to HK\$2 million) to 8.5 per cent of the amount or value of the consideration (for transactions over HK\$21,739,130), and is usually paid by the purchaser. The Stamp Duty Ordinance is the principal source of legislation governing this area.

The Inland Revenue Ordinance sets out three separate and distinct taxes on income: profits tax, salaries tax and property tax. Liability to tax under these three heads, as a general rule, is limited to persons or entities carrying on a trade, profession or business in Hong Kong, and to income that 'arises in or is derived from' Hong Kong. To this extent, the residence status of persons and companies is irrelevant to income tax assessment. Profits tax for 2015 and 2016 is 16.5 per cent for corporations and 15 per cent for unincorporated businesses.

In respect of loan repayments, as a general rule a borrower's interest expenses will be deductible where the lender is subject to Hong Kong profits tax on its receipt of the interest. In addition, where a financial institution (whether onshore or offshore) makes a genuine loan, interest expenses will generally be deductible.

IX COMPETITION LAW

The Competition Ordinance, Hong Kong's first cross-sector competition law, has been in force for over a year since it came into full effect on 14 December 2015. Previously, only the broadcasting and telecommunications industries were subject to competition law, as provided for in specific provisions of the BO and the TO (now largely repealed). The former TO provided a regulatory framework for the Communications Authority to consent to certain M&A involving carrier licensees in the telecommunications industry.

The Competition Ordinance retains a merger control regime in Hong Kong for the telecommunications industry known as the 'Merger Rule'. Like the regime under the TO, the Merger Rule applies only to mergers involving carrier licensees, and the Communications Authority has concurrent jurisdiction with the Competition Commission in relation to the Merger Rule. However, unlike the merger regime under the TO, the Competition Ordinance does not specify thresholds upon which regulatory consent is triggered. Instead, the Merger Rule refers to the acquisition of 'control', which could apply even if the acquisition involves a minority interest not exceeding 30 per cent. A merger could be prohibited if it has or is likely to have the effect of substantially lessening competition in Hong Kong. It is worth noting that notification of mergers is voluntary rather than mandatory, but in practice the Communications Authority is consulted in most (if not all) cases, even when no competition concerns are expected. The first case under the Competition Ordinance involved an announcement by the Communications Authority on 10 November 2016 of its decision not

to commence an investigation in respect of the HK\$9.5 billion acquisition¹⁵ by Green Energy Cayman Corp¹⁶ of the entire equity interests of Wharf T&T Limited, a carrier licensee under the TO, on the basis that the acquisition was unlikely to have the effect of substantially lessening competition in Hong Kong.

In the run up to the drafting and passing of the Competition Ordinance, which, on the whole, was supported by the public, there was some debate about whether there is a need for merger control in Hong Kong to govern general M&A activity (outside the telecommunications sector). The Public Consultation Paper on Detailed Proposals for Competition Law in 2008 showed a softening of the government's stance on this issue, from 'we do not need a merger control regime' to inviting views on three possible options regarding such a regime. The recommendation of the Commerce and Economic Development Bureau of Hong Kong (CED Bureau) was that merger activities are not to be regulated, except in the telecommunications sector, which is already subject to such regulation under the former TO. The CED Bureau stated that this proposal would give the Competition Commission more time to focus on its initial work of implementing the proposed Competition Ordinance, and would allow for a more effective assessment of whether merger control provisions would be desirable in other (or all) sectors in the future once the Competition Commission has accumulated some experience in the operation of the competition regime. This was the position ultimately adopted in the Competition Ordinance. It has been suggested that the Competition Commission would seek to introduce a fully fledged merger control regime within 'two to three years' of the Competition Ordinance taking full effect.

X OUTLOOK

The government has forecast that Hong Kong's GDP is likely to grow by 2 to 3 per cent in 2017.¹⁷ Hong Kong's economic performance in 2017 will be influenced by developments in external demand, the performance of the global economy and political developments in major advanced economies.

Overall, deal appetite in Hong Kong is high, with M&A markets remaining busy in the first quarter of 2017. During that period, the value of M&A transactions increased by 48.2 per cent compared to the first quarter of 2016.¹⁸

As with other markets across the world, Hong Kong has to grapple with the changing political climate in the US and Europe and various macroeconomic factors, including volatile foreign exchange rates. Tighter controls are expected to be imposed by the Chinese government on capital outflows from China to curb renminbi depreciation and investments that are regarded as speculative rather than strategic. There has also been a recent increase in regulatory scrutiny in China of outbound transactions. These measures are expected to result in a slowdown in outbound China investment, at least in the short term, as Chinese

15 www.wharftt.com/en/about_us_press_release_2016_20161110.html.

16 Green Energy Cayman Corp is indirectly owned by MBK Partners and TPG Capital.

17 Sources: 2016 Economic Background and 2017 Prospects, Financial Secretary's Office Government of the HKSAR (www.hkeconomy.gov.hk/en/pdf/er_16q4.pdf).

18 Source: Mergermarket. M&A activity totalled 147 deals with a value of US\$44,152 million in the first quarter of 2017, while M&A activity totalled 140 deals with a value of US\$29,802 million in the first quarter of 2016. The statistics shown include majority stake deals (over 30 per cent) and exclude lapsed or withdrawn bids.

companies contend with the more complex regulatory landscape. However, in the longer term, the expectation is that while overzealous investments may be curtailed, outbound investments that are considered to be strategic in nature should continue to be supported. Therefore, overall the outlook of the M&A market in Hong Kong for 2017 and beyond remains optimistic.

The key industries that are ripe for M&A activity are expected to include real estate, financial services and FinTech. China's 'One Belt, One Road' initiative is also expected to create opportunities for Hong Kong companies, particularly in the infrastructure and resources sectors.

Hong Kong has traditionally followed a 'market leads, government facilitates' principle in forming public policy. This has seen Hong Kong ranked as the world's freest economy by the Heritage Foundation for many years.¹⁹

19 Source: www.info.gov.hk/gia/general/201702/16/P2017021600208.htm.

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