Introduction
This article is part 1 of a series of publications that will describe the various aspects and steps of mergers and acquisitions (M&A) commonly conducted in Hong Kong with recognition of the facilitative role of the company secretary. Broadly speaking, mergers involve the absorption of one company into another and acquisitions may involve, usually, share acquisitions or asset transfers. Among the various means of conducting an M&A transaction – including amalgamation by virtue of a scheme of arrangement under the Companies Ordinance (Cap 622) – it is common that the M&A transaction will be done by way of share acquisition or asset transfer, which will be the focus herein.

Internal process
Any company engaging in an M&A transaction will invariably go through an internal process that will lead them to conduct further steps in the M&A transaction. Typically, the questions to be asked in this internal process include the following.

1. What does the company want to achieve by entering into the M&A transaction?
   It is important for any company looking at M&A opportunities to carefully articulate a growth strategy that should encourage both revenue and margin growth and that will create long-term benefits for the company. The board and management have to identify the sustainable competitive advantages that can be achieved through M&A transactions. Different considerations may become the driving forces behind an M&A transaction, for example market expansion, acquisition of new capabilities and better positioning in the competitive sphere. On the other hand, the board and the management should carefully measure the benefits against the costs of the increased scale or scope of business. For some companies, there may be a strategy committee set up within the board of directors to facilitate this internal process. For others, a less formal structure may be adopted. The role of the company secretary will be to assist in the collation of documents, arranging meetings, and, importantly, providing advice and collating the paper trail for the board and management.

Some common issues that the board and management should consider include the following.

- What are suitable acquisition targets?
- Should a private or public company be targeted and what are the ongoing regulatory obligations that will apply in each case?
- What will be the structure of the transaction – share acquisition or asset transfer?

2. How ready is the company for the M&A transaction?
The question of the readiness of the company for the M&A transaction is closely related to question 1 but will involve somewhat different considerations. In this regard, the board and the management should consider the following.

- Are the records of the company (both statutory and financial) sufficiently clear and complete for the due diligence process?
- Are the board and management sufficiently aware of the M&A process and their responsibilities throughout?
- Is the company sufficiently aware of its obligations to third parties (for example shareholders of the company, banks, suppliers, customers) in terms of confidentiality, pre-emptive rights and change of control restrictions that may be relevant in an M&A transaction?
- Is the company subject to restrictions on merger control or other restrictions under any applicable competition law?

While these issues will come up in the later stages of the M&A transaction, for example when the parties are conducting due diligence or are seeking the requisite consents to satisfy the conditions precedent to completion, it is important that the board and management have a sufficiently good grasp of the relevant issues, which will help tremendously in all the remaining stages of an M&A transaction. The company secretary will be involved in collation of documents and setting up a strong-room over them for due
Confidentiality

Once the board and management start to engage in discussion with other parties, both within and outside the company, all members of the board and management should be highly alert to confidentiality issues and proper measures should be put in place to maintain the confidentiality of information and documents relating to the potential M&A project. Such obligation is usually ongoing and may last even after a specific discussion with third parties has ended. Failure to abide by such obligations and comply with the relevant requirements may have negative consequences. On the other hand, good management of confidential information will help ensure a smooth M&A deal which is beneficial to all parties involved. In this connection, the company secretary will have to assist the board and management on orderly dissemination of information.

Why should I care about confidentiality?

It is important that the board and management understand clearly as to why confidentiality is important in relation to information and documents that may be exchanged during an M&A transaction. As noted above, there are both internal and external considerations. The company secretary should provide advice and assist the board and the management to understand the following.

- It is important to maintain confidentiality within the company to avoid unwanted publicity which may in some cases affect the morale of the staff and, in the worst case scenario, lead to a run-off by staff.
- Parties to an M&A transaction need to be able to exchange relevant information (for example business plans and financial information about themselves and/or the target companies) to discuss the legal and commercial parameters of the M&A transaction, without the fear that confidential information may be released, disclosed or used against the interests and intentions of the parties involved. Failure to comply with the confidentiality obligations owed to the counterparties may lead to legal liabilities as well as reputational damage to the parties concerned.
- A company is likely to be subject to various existing confidentiality obligations under contracts or arrangements with third parties, for example supply agreements, distribution agreements, joint-venture agreements, shareholders agreements or even the constitution of the companies. The relevant confidentiality obligations should be observed when engaging in conversations or discussions with third parties and, if necessary, consent should be obtained.
- Information obtained during an M&A transaction that involves listed companies (as counterparties or targets) is likely to be considered inside information. There are rules concerning the use of inside information and breach of these rules will result in criminal sanctions. Please see below for a further discussion of this issue.

How should confidentiality be protected?

To protect the confidentiality of the information and documents exchanged or used in an M&A transaction, the board and management should consider putting in place measures which are suitable to the company and effective to protect confidentiality of the relevant information. Some common measures which the company secretary will assist as part of the team to implement include the following.

- Confidentiality agreements. These agreements may take different forms and be under different names, for example non-disclosure agreement, mutual confidentiality agreement or confidentiality provisions hidden in a preliminary agreement or heads of agreement. It may be imposing confidentiality obligations in relation to information going ‘one-way’ (unilateral obligations), for example from the target company to the potential investor or ‘two-way’ (mutual obligations), for example between two merging entities. The exact form and wording will depend on the nature of the M&A deal. The agreement should be signed as soon as possible and in any event before any confidential information is exchanged. While this is usually the first document to be agreed and signed in an M&A transaction, the terms of a confidentiality agreement may extend indefinitely. The confidentiality agreement should cover the intended disclosures at all stages of the M&A transaction. It is important that the parties to a confidentiality agreement should clearly define the scope of the confidential information to be covered. Usually, the potential investor/buyer may want to minimise the restrictions on its use of the confidential information (and to set a finite date beyond which they are released of the confidentiality obligations), while the target company/seller will want the restrictions to be broader especially in the event that the deal does not close.
- Protocol for internal and external communications. Clear lines of communication for both external and internal communications should be established. This can be done by, for example, compilation of a telephone directory for the project setting out the team members of the company, the counterparties and the external advisors. A project name is usually helpful to avoid describing the nature of the proposed transaction in each communication which may increase the risk of unauthorised and/or unwanted disclosure. A group e-mail account will also be helpful in facilitating communication with all the team members within the company and with the correct team members of the counterparty or external advisors. It also helps differentiate what information is related to the project and facilitates secured storage of confidential information.
- Secured storage of confidential information. Considerations should be made as to where the physical files relating to the particular M&A transaction should be kept and stored. Similar considerations should apply to the storage of electronic files, for example password protected folders, information barriers with access restricted to designated members of the company.

It is crucial that the board and the management should ensure that all team members fully understand the confidentiality obligations binding on the company and each of them. Otherwise, none of the measures which are designed to facilitate compliance of confidentiality obligations will work.

Exclusivity

Under Hong Kong law, exclusivity in negotiation in contracts is not implied. Therefore, it is common for parties to a potential M&A transaction to agree some sort of exclusivity arrangement so that the parties commit to discuss and negotiate exclusively with the specified counterparty on the relevant transaction within an agreed period of time. The exclusivity arrangement may be contained in a preliminary agreement, heads of agreement or a term sheet. A key term to be agreed between the parties is the end date for the exclusivity arrangement, which is very much a matter of commercial negotiation between the parties. The board and the management should also be aware of any relevant regulatory requirements in relation to the
Inside information

The board and management should be aware of any inside information that may come into their possession during an M&A transaction, and the company secretary must help manage compliance and, where necessary, disclosure of the inside information as soon as practically possible.

Inside information is defined under the Securities and Futures Ordinance (Cap 571) (SFO). Generally speaking, it refers to specific information relating to a corporation, a shareholder or officer of that corporation or the listed securities of that corporation or their derivatives, and which is not generally known to the persons who are accustomed, or would be likely, to deal in the listed securities of that corporation but would, if generally known to them, be likely to materially affect the price of the listed securities.

Persons who obtain inside information during an M&A transaction must take extreme precautions to avoid dealings in the relevant securities or disclosure of such information to other parties who may deal in the relevant securities, as such conduct may constitute insider dealing in contravention of the prohibitions under the SFO.

The board and management should also be aware that the Takeover Codes (which apply to both public companies in Hong Kong as well as companies with a primary listing of their equity securities in Hong Kong) and the listing rules also restrict dealings in a target company's securities in certain specified circumstances.

External advisers

In a typical M&A transaction, a company will usually engage various external advisors including legal advisors, financial advisors and auditors. Also, there could be a valuer for example where there is an asset transfer. The company secretary must ensure that there is proper paper trail as there could be regulatory and other issues that arise during or after the transaction.

Legal advisors

A company will engage legal advisors that will assist the company to handle all the legal requirements and issues concerning an M&A transaction. The range of works and issues to be covered by legal advisors will vary from case to case. Common works that will be covered by legal advisors will include the following.

- preparing/reviewing, negotiating and concluding the legal documentation (including, for example, a sale and purchase agreement and the seller's disclosure letter)
- attending to the due diligence process (and for the buyer the preparation of a due diligence report)
- attending to the disclosure and other compliance requirements as may be imposed under the listing rules
- attending to the tasks that will need to be completed for the purpose of completion of the transaction, for example the seeking of consent, whether regulatory or from third parties such as joint venture partners, shareholders, banks, suppliers, landlords.

In specific circumstances, specialist legal advice may be required, for example, in relation to issues of competition law or environmental law. If the transaction involves foreign elements, for example subsidiaries in other jurisdictions, local counsel's support is often required.

Once an engagement with a legal advisor is confirmed, the company will invariably be asked to enter into a formal engagement document (an engagement letter) with the legal advisors which will set out among others, the agreed scope of work and the applicable fees.

The company secretary in many instances is facilitative of the communication of instructions and seeking the requisite advice. In any event, the company secretary should carefully ensure solicitor/client privilege through proper handling of papers.

Financial advisors

A financial advisor will assist a party to an M&A transaction to cover the financial and business aspects of the transaction. Typically, a financial advisor will assist a party to an M&A transaction with structuring of the deal, negotiation with the counterparties on the commercial terms of the M&A transaction, the valuation of the business and/or assets to be acquired or disposed of, working with the legal advisors to facilitate the various steps of a transaction and providing assistance with compliance of various regulatory requirements.

Similarly (as for the engagement of legal advisors), it is common that the company in an M&A transaction will enter into a formal engagement documentation (commonly an engagement letter) to confirm the agreed scope of work and the applicable fee and payment arrangement.

Depending on the regulatory requirements, there may be the need to appoint independent financial advisors to advise the independent directors and shareholders. The company secretary will again be an important facilitator of the processes.

Auditors

Auditors will provide their expert advice in relation to the financial data of the target companies or assets and will also assist the parties with preparation of the various accounts that may be required for the different stages of an M&A transaction, for example completion accounts. A similar engagement process will apply as for engagement of legal and financial advisors and the role of the company secretary in facilitating communications, handling papers and audit trails.

The members of the Takeovers, Mergers and Acquisitions Interest Group are: Michelle Hung FCIS FCS (Chairman), Dr David Ng FCIS FCS, Henry Fang, Kevin Hoi, Lisa Chung and Philip Pong. Mohan Datwani FCIS FCS(PE) serves as secretary. Please contact Mohan Datwani, Senior Director and Head of Technical and Research, HKICS, if you have any suggestions about topics relevant to this interest group at: mohan.datwani@hkics.org.hk.

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