

Singapore – M&A lessons in 2010

by Perry Yuen, Director and Shaun Tan, Associate, Legal Solutions LLC



Forewarned is forearmed. After the slowdown in M&A activity in 2008 and 2009, the deluge of transactions in 2010 was a welcome respite. As a foil to the resurgent optimism in the market, this article will highlight legal pitfalls gleaned from two recent M&A transactions which did not quite turn out as envisaged, so that the reader can take the pitfalls into account when structuring or advising on M&A transactions.

This article is meant to reflect the personal views of the authors and is not meant to be and should not be construed as legal advice.

The economic backdrop in 2010 and key M&As

Based on figures provided by the Ministry of Trade and Industry, Singapore's GDP growth in 2010 is estimated at some 14.7%. Bearing this in mind, and the fact that previous years were a time of consolidation and fund raising by many Singapore companies, we expect the trend of buoyant M&A activity to continue. A prime example of a Singapore company with a substantial war chest from funds raised in previous years, on the lookout for acquisitions is Capitaland. The various Capitaland entities had raised in excess of S\$4bn in previous years, and just recently, Capitaland China announced its acquisition of the real estate business of Hong Kong's Orient Overseas International for some S\$3.1bn in cash. Elsewhere in Singapore, the healthcare sector was shaken up by competitive bidding for Parkway Holdings where, in a seldom seen hostile bid by a SWF, Malaysia's Khazanah outbid India-based Fortis (controlled by billionaire brothers Malvinder and Shivinder Singh) to acquire Parkway Holdings in a deal worth S\$3.5bn and valuing Parkway Holdings Ltd at some 31 times 2010 earnings.

The largest M&A transaction commenced in 2010 was SGX's announcement of its S\$10.7bn merger with ASX. Most market watchers will agree that in light of the intense competition between the global stock exchanges and the ever present quest for cost savings by stock exchanges, a merger between two major Asian exchanges was not surprising – what will be worth observing will be how SGX and ASX surmount the difficulties raised in a merger impinging on possibly differing national interests.

In this article, rather than setting out a broad overview of the M&A market and regulations in Singapore, we describe below two Singapore High

Court cases, and the lessons which can be learned from them.

Takeovers – better safe than sorry

The case of *Oversea-Chinese Banking Corp Ltd vs. Asia Pacific Links Ltd* ('OCBC vs. APLL')

The very recent and very peculiar Singapore public takeover case of OCBC vs. APLL shows the importance of information verification in a takeover scenario.

On February 18, 2008, APLL launched a voluntary conditional cash offer for all the issued shares in Jade Technologies Ltd ('Jade') which it did not already own or control, and OCBC was appointed as the financial adviser to APLL for the offer.

In the offer announcement, it was stated that APLL held 46.54% of Jade's issued share capital, and OCBC confirmed that sufficient financial resources were available to APLL to satisfy full acceptance of the offer.

As it turned out, APLL's director and sole shareholder, Dr Anthony Soh, had intentionally made false representations to OCBC to deceive OCBC into agreeing to be appointed as the financial adviser and issuing the offer announcement. Truth of the matter was that APLL did not actually hold 46.54% of Jade's issued share capital, did not even have the resources to complete the offer; and had taken advantage of the offer to dispose of a 10% stake in Jade without disclosure.

From a professional adviser's viewpoint, OCBC vs. APLL sheds light on (i) the standard of care a professional adviser should adhere to and the effect this has on civil liability; and (ii) the importance of the terms and conditions in a professional adviser's mandate letter to a client.

Standard of care – Securities Industry Council (SIC).

By way of background, on October 14, 2008, the SIC had found OCBC to have fallen short of the standard of care required under the Takeover Code of Singapore, and had not acted responsibly and taken all reasonable steps in the discharge of its duties.

Specifically, (i) OCBC had not taken sufficient steps to verify APLL's ownership over Jade shares especially since it was aware that APLL had in place a share lending agreement with a third party, which meant that APLL's actual shareholding was less than the announced shareholding figures; and (ii) OCBC had not sought to independently verify third party confirmations as to APLL's financial resources.

The above facts can be distilled into one key point – how far does a professional adviser have to go to verify information submitted or represented by a client?

The SIC's pronouncement contained a clear answer, that a professional adviser cannot accept a client's representations at face value especially if there are indicators to alert the adviser otherwise. The adviser must make further enquiries at that time, up to the standard of verification similar to that when conducting anti-money laundering checks, including independent verification.

Standard of care – civil liability. The Singapore High Court took the view that although a breach of the Code may tend to establish liability, it is not determinative, and on the facts, it was Dr Anthony Soh's misrepresentations to OCBC, rather than OCBC's failure to comply with the Code, which caused the offer to collapse. Therefore APLL's counterclaim against OCBC for negligence failed. Two points may be inferred from this judgment:

First, the High Court did not reject the SIC's pronouncement on the standards required of a financial adviser, and accepted that in advising entrepreneurs, a financial adviser "should check the information provided by the customer very carefully". This court pronouncement on the standards under the Code should be kept in mind by financial advisers in a takeover in Singapore. In the UK for instance, the Takeover Panel is potentially subject to judicial review, and therefore it is certainly prudent from a risk management perspective, to pay heed to court pronouncements.

Second, and while this may be a fairly technical legal point, one should note very carefully that the High Court elaborated at length on the "fraudulent and/or negligent misrepresentations" by Dr Anthony Soh, and that APLL "had perpetrated a fraud against OCBC", and the High Court's decision on this case hinged on the High Court determining which party's actions were the direct and proximate cause of the parties' losses owing to the collapse of the offer.

In other words, the establishment of liability rests on, simply, which party was more blameworthy and caused the transaction to fail, and as mentioned above, the High Court found that it was Dr Soh's repeated misrepresentations to OCBC and not OCBC's breach of the Code that had resulted in the collapse of the offer.

Mandate letter T&Cs. In this case, the High Court gave full effect to the provisions of OCBC's mandate letter obliging APLL to provide correct and accurate information and to indemnify OCBC for losses suffered in connection with its appointment as financial adviser, save where OCBC had been grossly negligent. APLL was liable to indemnify OCBC for losses suffered.

Post Jade and OCBC vs. APLL - implications for professional advisers. The favourable outcome for OCBC in the OCBC vs. APLL case rested on the High Court's finding that it was Dr Soh's repeated misrepresentations to OCBC that had resulted in the collapse of the offer. What about where circumstances are such that the failure of a takeover offer is not solely attributable to the fraudulent actions of the offeror, and perhaps was a result of a financial adviser falling short of the requirements of the Code coupled with negligent misrepresentation on the part of the offeror?

The conclusion may sound obvious, but a financial adviser to such an offeror would have absolved itself from liabilities or improved its position arising from the collapse of such an offer by:

- having undertaken independent verification of key information, such as adopting similar standards recommended by the Financial Action Task Force in relation to customer due diligence and record keeping; and
- adopting a well crafted mandate letter which, *inter alia*, obliges the offeror to provide correct and accurate information and to indemnify the financial adviser for losses it may suffer in connection with its appointment as financial adviser.

Contractual certainty

The case of *Norwest Holdings (in liquidation) vs. Newport Mining Ltd* ('*Norwest vs. Newport*')

The case of *Norwest vs. Newport* serves as a very timely reminder of the need for contractual certainty and careful crafting of legal documentation between buyers and sellers. Commercial parties should pay heed to the legal intricacies in structuring their transactions, or they run the risk of litigation, which over and above the issue of cost and time lost, carries the real danger that the court may interpret the transaction somewhat differently from what the commercial parties envisage it to be.

Key facts of *Norwest vs. Newport*. *Norwest*, a company in liquidation, initiated a process of putting up for sale its shares in a wholly-owned subsidiary ('Sale Shares'), which in turn owned a Chinese corporation which owned mining rights to phosphate rock mines and production facilities in Sichuan, China ('Mining Business').

The Sale Shares were expressed to be sold on an as is, where is, basis, and the sale process set out in an information memorandum prepared by Norwest's liquidator ('Liquidator') was, *inter alia*:

1. conduct of due diligence;
2. interested parties to deliver a "firm letter of offer" (in a format specified by Liquidator); and
3. (a) Liquidator responds with acceptance, followed by (b) negotiation and execution of a definitive sale and purchase agreement with successful bidder.

Unfortunately for Norwest, and Newport, in the course of step (3)(a) of the transaction, and unknown to Newport and the Liquidator at the time when the Liquidator responded with its acceptance of Newport's offer, the 2008 Sichuan earthquake struck some two hours before the Liquidator's acceptance. The Sichuan earthquake had caused severe damage to the Mining Business.

Not surprisingly, after learning of the earthquake and the damage to the Mining Business, Newport informed Norwest that Newport would not be going ahead with the purchase on the basis that the parties have not entered into a definitive sale and purchase agreement, and accordingly, there was no binding and enforceable contract.

In this case, the Singapore High Court held that, *inter alia*, (i) a binding contract had arisen upon the Liquidator's acceptance at step (3)(a); (ii) the true subject matter of the contract was not the Sale Shares, but the Mining Business; and (iii) the sale being on an 'as is, where is' basis did not mean that a buyer would have to accept the Mining Business after it had been severely damaged by the earthquake.

The findings of the High Court set out above may come as a surprise or counter-intuitive to some commercial parties and their respective professional advisers.

Letter of offer – a binding contract? It is commonly presumed by commercial parties involved in sale and purchase transactions that a binding and enforceable contract arises and only occurs upon the signing of definitive agreements. There is a lot of case law on this point, and the key point to remember is that if the substantive terms to a sale and purchase transaction are agreed and set out in a letter of offer, then in the absence of parties' intentions to the contrary, the Singapore courts will find that a binding contract has arisen upon the signing of a letter of offer, despite the parties not having entered into a definitive agreement yet.

Accordingly, during the course of negotiating an M&A transaction, care must be taken by each party to ensure that it does not inadvertently enter into a binding contract when it does not yet intend to. On the other hand, if the proposed deal is 'too good

to be true' and the buyer wants to lock in the seller as quickly as possible, a simple letter of offer with the substantive terms clearly set out could be the fastest way of reaching a binding contract with the seller, even if the letter of offer states that it is "subject to the terms of conditions of the sale and purchase agreement to be negotiated".

Subject matter – Sale Shares or the Mining Business?

Norwest argued that the subject matter of the contract was the Sale Shares, and therefore, the contract was unaffected in any way by the damage caused by the Sichuan earthquake to the Mining Business. The High Court held otherwise, stating that the true subject matter of the contract was not the Sale Shares but the Mining Business on the bases that:

- the contents of the information memorandum issued by the Liquidator described the sale of the Sale Shares as an opportunity to gain access to the Mining Business; and
- the parties' conduct throughout the sale process, including the Liquidator facilitating Newport's due diligence process on the Mining Business.

Parties must therefore be cognisant, especially in the case of the sale and purchase of the shares of a single purpose vehicle, of the effects of Singapore laws on the interpretation of the true subject matter of a transaction and the legal ramifications thereof (see discussion on 'as is, where is' below), that unless otherwise carefully drafted, the true subject matter of a share sale transaction would be the underlying assets of the SPV, rather than the shares of the SPV. **'As is, where is' and implied covenant.** Since the High Court found that the true subject matter of the sale was the Mining Business rather than the Sale Shares, the sale being on an 'as is, where is' basis would refer to the state and condition of the Mining Business.

The High Court then held that unless otherwise intended between the parties, the relevant time for determining the state and condition of the subject matter would be when the buyer made the offer.

This means that as a result of the Sichuan earthquake, Norwest was not able to deliver the Mining Business in substantially the same state and condition it was actually in at the time Newport made the offer to purchase, and since Newport would not be receiving what it offered to buy, the High Court found that Newport was not bound to accept the Sale Shares or make payment.

In practical terms, even though the subject matter of a sale and purchase transaction is to be sold on an 'as is, where is' basis without warranty or guarantee, a seller will nevertheless be required to observe an implied covenant to deliver the subject matter in no lesser state and condition as when the buyer had made its offer for the subject matter.

Conclusion

The reality of M&A transactions is that there is always the inevitable rush to complete structuring considerations, due diligence and the preparation of financial and legal documentation. In doing so, professional advisers usually do not have the luxury of time to explain what would appear to be fairly obvious and accepted issues within their respective areas of expertise, but which could turn out to be counter-intuitive to other sets of professional advisers and the principals involved. Taking some time to bring up or address these counter-intuitive issues at the appropriate

juncture of each stage of a transaction would go a long way in reducing the risk of unnecessary, time-consuming and costly litigation.

Authors:

Perry Yuen, Director

Tel: +65 9685 6899

Shaun Tan, Associate

Tel: +65 9791 5717

Legal Solutions LLC