Baker & McKenzie

Asia Pacific
Acquisition Finance - The Essentials

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Editor's Note

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Australia

1. Is there any prohibition on a company incorporated in Australia providing Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

Part 2J.3 of the Corporations Act 2001 (Cth.) (the "**Corporations Act**") regulates the provision of financial assistance by a company for acquiring shares in that company or a holding company. While the giving of Financial Assistance is permitted under Section 260A of the Corporations Act, it is permitted under regulated conditions only.

Section 260A(1) states that:

"A company may financially assist a person to acquire shares (or units of shares) in the company or a holding company of the company only if:

(a) giving the assistance does not materially prejudice:

 (i) the interests of the company or its shareholders; or

 (ii) the company's ability to pay its creditors; or

(b) the assistance is approved by shareholders under Section 260B; or

(c) the assistance is exempted under Section 260C".

Section 260A(1)(a) is intended to allow the company to undertake normal commercial transactions which do not prejudice the company's financial position. However, there is no definition of "material prejudice" in the Corporations Act and this is, therefore, a question of judgement to be assessed on the particular facts and circumstances of each transaction. Particular regard must be paid to the assistance to be given and the financial consequences for the company and its shareholders.

As Financial Assistance is often complex in nature, it may be difficult to assess with certainty whether there will be any material prejudice.

Australia

Therefore, where the assistance does not fall within one of the exemptions under Section 260C, it is more usual to obtain shareholder approval under Section 260A(1)(b) than to rely on a determination that no material prejudice will occur.

The requirements for obtaining shareholder approval (commonly known as the "**Financial Assistance Whitewash Procedure**") are set out in Section 260B. Approval must be given by special resolution passed at a general meeting of the company or by a resolution agreed to, at a general meeting, by all of the ordinary shareholders[1].

However, it is not just the shareholders of the company giving the Financial Assistance who must approve that assistance:

(a) under Section 260B(2), if the company will be a subsidiary of an Australian listed corporation immediately after the acquisition, then the Financial Assistance must also be approved by special resolution passed at a general meeting of that Australian listed corporation[2]; and

(b) under Section 260B(3) if, immediately after the acquisition, the company will have an Australian holding company that is not listed and is not itself a subsidiary of an Australian corporation, the Financial Assistance must also be approved by a special resolution passed at a general meeting of that ultimate Australian holding company.

Sections 260B(5) to (7) set out procedures to be followed in obtaining the relevant shareholders' approval. The first step is for the company to hold a directors' meeting to approve the Financial Assistance documentation which typically includes, the relevant notice to shareholders, the shareholders' resolutions setting out the details of the Financial

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1 There is no need to hold a meeting where: (a) the company is a proprietary company and all of the members agree to proceed by way of a written resolution; or (b) the company is a single member company and the resolution is passed by way of a written resolution signed by the sole member.

2 An Australian listed corporation cannot approve the financial assistance by way of written resolution signed by all members but must hold a general meeting. This may not always be practical.

Assistance being given and approvals being sought, and the relevant forms which are required to be lodged with the Australian Securities & Investments Commission ("**ASIC**").

Once the company's directors have approved the Financial Assistance documentation, the relevant notice to shareholders, together with all documentation relating to the Financial Assistance that will accompany the notice to shareholders when sent to the shareholders, must be sent to the shareholders. At the same time, the company must lodged at ASIC a "Notification of financial assistance details" (ASIC Form 2602), together with the relevant exhibits.

Once the shareholders' meeting has been held (or the appropriate resolutions have been passed by written procedure), a further notice must be lodged at ASIC notifying it of the intention to give Financial Assistance (ASIC Form 2601). Financial Assistance cannot be given until at least 14 days after the lodgement of ASIC Form 2601[3]. This means Financial Assistance typically can be only given after an acquisition is completed.

The exemptions provided in Section 260C are for Financial Assistance which is given:

(a) in the ordinary course of commercial dealing and consisting of:

- (i) acquiring or creating a lien on partly paid shares in the company for amounts payable to the company on the shares; or
- (ii) entering into an agreement with a person under which the person may make payments to the company on shares by instalments;

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3 The effect of Section 105 of the Corporations Act and Section 36 of the Acts Interpretation Act 1901 (Cth) is, according to the generally accepted view, that there must be 14 days between the filing of ASIC Form 2601 and the giving of the financial assistance. That is, if ASIC Form 2601 is lodged on 1 January, the financial assistance cannot take place until 15 January. However, if time permits, the more cautious approach of allowing 14 clear days may be preferred (that is, if ASIC Form 2601 is lodged on 1 January, the financial assistance cannot take place until 16 January).

(b) by a financial institution in the ordinary course of its business on ordinary commercial terms;

(c) where a company issues debenture to raise money, by the subsidiary providing a guarantee or other security in the ordinary course of commercial dealing for the repayment of the money by the holding company;

(d) under an employee share scheme approved by a general meeting of the company;

(e) by a reduction of share capital or a share buy-back in accordance with Part 2J.1 of the Corporations Act;

(f) under a court order; or

(g) by a company discharging on ordinary commercial terms a liability incurred on ordinary commercial terms.

Failure to comply with Part 2J.3 of the Corporations Act does not affect the validity of the Financial Assistance or of any contract or transaction connected with it, nor is the company guilty of any offence (as it is considered to be a 'victim' (Section 260D(1) of the Corporations Act)).

However, any person who is involved in a company's contravention of Part 2J.3, contravenes Section 260D(2) of the Corporations Act. This is a civil penalty and the remedies available include:

(a) disqualification from managing corporations (Section 206C);

(b) penalty of up to AUD200,000 (Section 1317G); or

(c) an order to compensate the company (including for any profits made by the person resulting from the contravention) (Section 1317H).

Section 260D(3) of the Corporations Act further provides that where the involvement of a person is dishonest, then that person commits a criminal offence which is punishable by a maximum penalty of a fine of 2,000 penalty units (AUD220,000) or imprisonment of up to five years, or both (Section 1311 and Schedule 3).

Under Section 79 of the Corporations Act, such 'involvement' includes:

(a) aiding, abetting, counselling or procuring the contravention;

(b) inducing (whether by threats or promises or otherwise) the contravention;

(c) being in any way (directly or indirectly) knowingly concerned in, or party to, the contravention; or

(d) conspiring with others to effect the contravention.

Clearly this wide definition is capable of extending liability to Lenders providing finances for the acquisition and/or the lawyers acting for the parties to the transaction.

2. What are the implications under the corporate benefit laws of Australia for a company providing Financial Assistance?

In Australia, directors of a company have a duty to act in good faith, for the benefit of the company as a whole and for a proper purpose. This duty arises both under the general law (as a fiduciary duty) and also under Sections 181 and 184 of the Corporations Act.

As this duty also applies to dealings between companies in a corporate group, when considering providing Financial Assistance for the acquisition of the company's shares, directors must continue to act in good faith for the benefit of that company. Although the benefit may be either direct or indirect, it may still be difficult for a director to determine if the provision of the Financial Assistance (while in the best interests of the holding company and/or group of companies as a whole) is actually in the best interests of the company.

Therefore, Section 187 of the Corporations Act provides that, where a company is a wholly-owned subsidiary, a director will be taken to act in good faith in the best interests of the subsidiary if:

(a) the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company; and

(b) the director acts in good faith in the best interests of the holding company; and

(c) the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act.

This section does not apply where the company is only partly owned, and accordingly, if the Financial Assistance was to be given by a company for the acquisition of only some of its shares, then the directors would be required to act for the benefit of the company as a whole, including the minority shareholders.

When determining whether an act is for the benefit of the company, consideration must also be given to the solvency of the company. It has been held that if the company is insolvent or <u>nearly insolvent</u> then the term "interests of the company" will include the interests of the creditors.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarisation, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The most typical types of security taken in acquisition finance transactions over property in Australia include:

(a) for shares, share mortgages – mostly equitable, although they can be legal mortgages;

(b) for other assets, fixed and/or floating charges; and

(c) for any land, real property mortgages.

Certain charges over the assets of a company must be registered with ASIC. Failure to register, if required, will affect the enforceability and priority of that charge.

Mortgages over real property must also be registered with the land registries of the relevant States and Territories.

Depending on the nature of the chargor, and the type of security granted, other registration requirements may be imposed by each State and Territory.

Stamp duty is a State and Territory government tax which is levied on many documents, including loan securities. This mortgage duty is being phased out and is now only applicable in New South Wales. The rate of duty in New South Wales is 0.4% and is payable on the amount of secured debt (and may also include other secured financial accommodation such as forbearances). The amount of duty payable in New South Wales is usually calculated based on a percentage of the amount secured by the security, but it can also be dependent on the value of the assets located in each particular State or Territory. While mortgage duty is being phased out, however, other forms of stamp duty will frequently apply to certain dealings in securities and specialist advice on the stamp duty aspects of each particular transaction needs to be obtained.

4. How long, following acquisition of a foreign target company, would it usually take in Australia for a local subsidiary of such company to grant a guarantee/ security?

This depends on the number of Australian target subsidiary companies involved and the group structure including whether any Australian parent company (either direct or ultimate) is a public company. Not only must shareholders of the company that is granting Financial Assistance effect a whitewash: the ultimate Australian holding company must also approve the Financial Assistance, and where the holding company (either direct or ultimate) is a public company, that holding company must also obtain the consent of its shareholders by means of the Financial Assistance Whitewash Procedure.

Generally, where there are Financial Assistance issues, the quickest period in which an Australian subsidiary can provide the guarantee or security is

15 days from the acquisition. This would require a shareholders' meeting to be held on the day of the acquisition (following all of the necessary lodgements at ASIC and notifications to shareholders being issued) and then for the notification of the intention to give Financial Assistance (ASIC Form 2601) to be lodged at ASIC on that same day. The Financial Assistance can then be provided after 14 clear days from the day that ASIC Form 2601 is lodged.

Where a public company is involved, that company will often try to avoid having to call an EGM of its shareholders and will prefer to wait until its next AGM before approving the Financial Assistance to be given, either by it directly, or more usually by one of its Australian subsidiaries. It could therefore be up to a full year before the next AGM and, once held, the shareholders' approval has to be lodged at ASIC and a further 14 clear days must elapse before the Financial Assistance can actually be given. It would be unusual for a lender to agree to wait for the next AGM if it is almost a year away. However, periods of between three to six months for the provision of the security are not uncommon.

5. Are there any restrictions on foreign banks lending to companies in Australia? Are interest payments to foreign banks typically subject to withholding tax?

Restrictions on foreign banks lending in Australia

A foreign bank lending in Australia may be subject to various regulatory regimes and licensing requirements if it is:

(a) carrying on a banking business in Australia;

(b) carrying on a financial services business in Australia;

(c) carrying on business in Australia; or

(d) a "registrable corporation" under the Financial Sector (Collection of Data) Act 2001 (the "Financial Sector (Collection of Data) Act").

(i) Carrying on a banking business

A foreign bank which carries on a "banking business" under the Banking Act 1959 (the "**Banking Act**") must do so through a locally incorporated subsidiary or branch and must be approved by the Australian Prudential Regulation Authority ("**APRA**") to be an Authorised Deposit-taking Institution and will be regulated by APRA under the Banking Act. A company is deemed to be carrying on a banking business under the Banking Act if it is taking deposits, making advances or conducting other financial activities prescribed by the Banking Regulations 1966. If a foreign bank merely lends to companies in Australia and does not take deposits, it will not require approval by APRA or be regulated by the Banking Act.

(ii) Carrying on a financial services business

A company which carries on a "financial services business" in Australia must be licensed to do so by ASIC and will be regulated by ASIC under chapter 7 of the Corporations Act. A company is deemed to carry on a financial services business if, among other things, it deals in a financial product as defined in the Corporations Act. Credit facilities are generally excluded from the definition of "financial product" (Section 765A(h) of the Corporations Act) and the provision of a credit facility only to an Australian company will not trigger regulation by ASIC as a financial services business.

(iii) Carrying on business in Australia

A foreign company which "carries on business" in Australia must be registered with ASIC under the Corporations Act and comply with various disclosure and other requirements imposed on registered foreign companies under the Corporations Act. There is no specific test for determining if a company is carrying on business in Australia and whether doing so is dependent on the circumstances in each particular case. Lending to an Australian company on a one-off or very limited basis will in most cases probably not qualify as carrying on business in Australia, but repeated lending and a course of dealing will most likely constitute carrying on business and require registration.

(iv) Registrable companies

A company which is a "registrable corporation" under the Financial Sector (Collection of Data) Act must be registered with APRA as such and, although it will not be subject to supervision by APRA, it must comply with certain disclosure and reporting requirements. A foreign company is a "registrable corporation" if it has assets exceeding AUD25 million and, among other things:

- its principal business activity in Australia is the provision of finances; or
- the value of the debts due to it as a result of such activity is equal to 50% or more of its total assets in Australia.

Interest payments and withholding tax

Interest paid to foreign banks that are not carrying on business through an Australian permanent establishment for the purpose of lending the money by an Australian resident borrower that is not operating through an offshore permanent establishment or non-resident borrowers carrying on business through an Australian permanent establishment, is subject to a withholding tax of 10% of the gross interest paid. The rate of withholding tax may be reduced to nil where interest is paid to a US, UK, Finnish, Japanese, Norwegian, South African or French resident financial institution which:

(a) qualifies for the benefits of the double tax agreement ("**DTA**") Australia has entered into with the relevant jurisdiction; and

(b) is unrelated and operating wholly independently of the Australian borrower.

A financial institution for these purposes includes enterprises that substantially derive their profits by raising debt finance in their financial markets or by taking deposits at interest and using those funds in carrying on a business of providing finance. It is not limited to banks.

6. If a takeover bid which relies on bank debt is made for a publicly listed company in Australia, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Both the Corporations Act and the Australian Takeovers Panel (the "**Panel**") impose certain threshold requirements and disclosure obligations as to certain funds in a takeover bid for an Australian public company.

Corporations Act

The Corporations Act regulates public takeovers of Australian companies and under it, bidders cannot:

(a) be reckless when announcing a bid as to whether they can perform if a substantial proportion of the offers under the bid are accepted (Section 631(2)(b));

(b) in a market bid, impose any conditions on the bid (Section 625(1)); or

(c) in an off-market bid, make a bid that is a conditional on events within its control or discretion (Section 629).

The Corporations Act also requires that certain information relating to a bidder's funding be disclosed on the bidder's statement required to be filed with ASIC including, among other things, the identity of any person who is to provide cash consideration from that person's own funds and any arrangements under which that cash consideration is to be provided.

Australian Takeovers Panel

The Panel has broad power to intervene in public takeover bids when it determines "unacceptable circumstances" exist in relation to a takeover. In its Guidance Note 14: Funding Arrangements ("**Note 14**"), the Panel states that in order to avoid unacceptable circumstances arising from funding arrangements, a bidder must at all times have (and maintain) a reasonable basis to expect that it will have sufficient funding arrangements in place to satisfy full acceptance of its offers. The Panel explained that what constitutes a reasonable basis depends on the circumstances of each individual case and also changes throughout the period from the announcement of a bid to the payment of shareholders, with the required degree of certainty increasing as time progresses. Some guidance is provided by Note 14 in the form of examples of situations in which the bidder will most likely not have a reasonable basis to believe it will have sufficient funding. They include, among others, where financing arrangements:

(a) remain subject to internal credit approval;

(b) are the subject of an informal or unenforceable arrangement;

(c) remain subject to documentation (unless there is a binding commitment in place which provides the required reasonable basis);

(d) are on a 'best endeavours' basis; and

(e) are subject to conditions precedent which the bidder does not have a reasonable basis to believe will be satisfied or waived.

In practice, a commitment letter and credit approved term sheet will usually meet the 'reasonable basis' requirement of Note 14 if they are binding and set out all material terms and conditions.

Note 14 also requires that a bidder disclose in its bidder's statement discussed above or other disclosure documents the nature and details of its funding arrangements.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Section 555 of the Corporations Act states that all debts and claims will rank equally and, if the property of the company is insufficient to meet them in full, they will be paid proportionately. Section 556 of the Corporations Act then provides a list of categories of creditors who will be paid ahead of other creditors.

In general, in the winding up of a company, the order of ranking of creditors is:

(a) creditors with security (such as a real property mortgage or a charge over the company's assets);

(b) unsecured creditors given priority by Section 556. Section 556 lists different classes of unsecured creditors with priority over other unsecured creditors. Such classes include, among others:

 (i) costs and fees of the liquidator and administrator, including:

 - costs and expenses properly incurred by a relevant authority in preserving or realising or getting property of the company;
 - applicant's costs in obtaining the winding up order; and
 - remuneration of the relevant authority, his/her partners or staff for services provided, and expenses incurred by the relevant authority for services provided by a third party that could instead have been reasonably provided by the relevant authority, his/her partners or staff; and

 (ii) employees' wages and superannuation contributions payable by the company in respect of services rendered to the company prior to liquidation (unlimited for ordinary employees); and

(c) ordinary unsecured creditors.

Within the band of creditors with security, the Corporations Act determines the priority of payment between competing charges which are registrable under the Corporations Act. Sections 279 to 282 set out the order of priorities, but in general, the following rules apply:

(a) registered charges take priority over unregistered charges (which are registrable and should have been registered under the Corporations Act), unless the later charge had notice of the earlier unregistered charge;

(b) earlier registered charges take priority over later registered charges, unless the later charge had notice of the earlier charge; and

(c) later fixed charges take priority over floating charges, unless the floating charge was registered with a negative pledge.

The order of priority of charges may also be affected by any intercreditor agreements or similar agreements and arrangements between the secured creditors.

8. Is interest on debt incurred to acquire a company in Australia deductible from earning for tax purposes? Are there any thin capitalisation thresholds?

Interest payments on debt used to fund an acquisition are tax-deductible in Australia.

There are, however, thin capitalisation rules which limit debt deductions for companies which are geared in excess of certain thresholds. Under the rules, debt deductions will be denied to the extent a taxpayer's debt exceeds certain acceptable thresholds.

The rules apply to foreign entities investing in Australia, Australian entities investing outside of Australia and to foreign controlled Australian entities, and can apply where the taxpayer's total debt deductions in an income year (1 July to 30 June) exceed AUD250,000.

The main thresholds are broadly:

(a) for general corporates – the debt must not exceed 3/4 of the value of the average net value of the assets of the entity;

(b) for authorised deposit taking institutions ("**ADI**") – equity capital of at least 4% of the bank's risk-weighted Australian assets; and

(c) for financial entities (non-ADI) – the debt must not exceed 20/21 of the average net value of the assets.

Where an entity's debt level exceeds the relevant thresholds set out above, it may still be able to claim its debt deductions if the debt satisfies an arm's length test, which provides that certain factual assumptions and the consideration of a range of relevant factors must be applied in coming to an amount of debt that would have been borne by an independent commercial party operating under the same conditions and terms.

The characterisation of debt and equity is based, broadly speaking, on economic substance rather than legal form.

9. Will contractual subordination be honoured by a liquidator or bankruptcy trustee in Australia?

In deciding whether to honour a contractual subordination, a liquidator or bankruptcy trustee will have to consider three main issues arising in relation to the subordinated debt on the insolvency of the debtor: first, the legal structure of the subordinated debt arrangement; second, whether creditors are required to be treated on a *pari passu* basis; and third, any set-off rights in insolvency.

Subordinated debt structure

There are different structures of contractual subordination. Under the simplest type of contractual subordination, the relevant parties will agree that the subordinated creditor does have rights in respect of the debt, but that it will simply not exercise them until the senior creditor has been paid in full.

A contractual subordination can also be drafted so that the subordinated debt is contingent debt. As such, the subordinated creditor agrees that it has no rights in respect of repayment of the subordinated debt until such time as the senior creditor has been paid in full. In other words, the rights of the subordinated creditor are contingent or conditional upon the senior creditor being repaid.

At first consideration, it appears that the differences between the two forms of contractual subordination are theoretical rather than real; however, each arrangement will be handled differently upon the insolvency of the debtor. The particular concern in this context is the operation of statutory set-off rights under Section 553C of the Corporations Act (as discussed in paragraph (c) below).

Pari passu

Generally, creditors of a company will rank equally in priority, other than creditors having a statutory priority, on the winding up of that company (see Sections 501 and 555 of the Corporations Act).

A line of cases has debated whether debt subordination arrangements would be upheld on the insolvency of the debtor company. In the early 1990s, in what was regarded as a confirmation of the Australian position, Section 563C was introduced into the Corporations Act. Section 563C provides that nothing will render a debt subordination by a creditor of a company unlawful or unenforceable, except so far as the debt subordination would disadvantage any creditor of the company who was not a party to, or otherwise concerned in, the debt subordination.

At a general level, the purpose of Section 563C is to ensure that contractual subordination arrangements are not invalidated merely because of the *pari passu* rule in Section 555 but are upheld on the insolvency of the debtor, given that other creditors of the debtor who are not party to the arrangements are unlikely to be disadvantaged by the subordination. However, Section 563C will not protect every subordination arrangement on the insolvency of the debtor. Some of the problems which still exist are:

(a) Section 563C defines, in some detail, the type of debt subordination to which it applies. As a result, the section may not apply to certain existing structures that do not fall within the strict wording of the definition in the section; and

(b) Section 563C attempts to resolve one issue only, that is, the application of the general *pari passu* rule in Section 555 to subordinated debt. It does not deal with other issues that also impede the efficacy of debt subordination on the insolvency of the debtor, in particular, the exercise of set-off rights in insolvency by a subordinated creditor.

Statutory set-off

Section 553C was introduced in 1992 into the Corporations Act. In general terms, the section states that a creditor of a company in liquidation can set off debt it owes to the company in liquidation against the debt owed to it. However, it should not be able to claim the full amount due to it from the insolvent company in circumstances where it owes any amount to the insolvent company which it does not pay, or does not pay in full, leaving the liquidator to pursue that creditor separately in respect of such amount.

Section 553C poses a difficulty in the context of subordinated debt arrangements. In any subordination agreement, the senior creditor is likely to require that the subordinated creditor agree not to exercise any rights of set-off it might have against the debtor. The intention will be to ensure that part of the subordinated debt is not repaid without being subject to the subordination arrangement. The accepted view is that compliance with Section 553C is a mandatory provision which is not possible to contract out of. Therefore, this may be of concern to potential senior creditors.

Contingent debt subordination should protect the position of a senior creditor from the adverse consequences of Section 553C. Under such arrangement, because the subordinated debt is contingent, there will be no debt to set off against amounts owed by the subordinated creditor to the debtor until the senior debt has been repaid. A general contractual debt subordination, on the other hand, does not offer this protection.

China

1. Is there any prohibition on a company incorporated in China providing Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

There is no concept of Financial Assistance under PRC law and therefore there is no particular prohibition on a PRC company providing security or other forms of Financial Assistance in connection with an acquisition of equity interests in such PRC company or its direct or indirect holding company.

However, Article 16 of the Company Law of the PRC (effective 1 January 2006) (the "**PRC Company Law**") contains a general restriction on PRC companies providing third party guarantee or security whether or not the secured indebtedness is for the purpose of an acquisition. Where a PRC company provides a guarantee or security to guarantee or secure the liabilities of its shareholder(s) or a person who actually controls the PRC company, the provision of the guarantee or security must be approved by the shareholders. Approval has to be given by a shareholders' resolution to be passed by more than half of the shareholders present at the meeting and entitled to vote. The shareholders whose debts are being secured by the company and any shareholder controlled by the de facto controller are not entitled to vote.

In the event that the beneficiary of the guarantee/security is a party located outside China (the "**Foreign Party**"), the restrictions relating to 'Foreign Security' will also apply. Details of these restrictions are explained in the answer to Question 3.

2. What are the implications under the corporate benefit laws of China for a company providing Financial Assistance?

PRC law does not apply a 'corporate benefit' or 'commercial benefit' test to a PRC company in deciding whether or not a transaction should be entered into by that company.

However, the PRC Company Law imposes a general duty of diligence and a general duty of loyalty on the directors, supervisors and senior managers of a PRC company. They should not, by taking advantage of their functions and powers, accept bribes or other unlawful income, nor may they misappropriate the property of the company. Such duties are roughly similar to the fiduciary duties under the common law, but the exact scope of these duties is not set out clearly in the PRC Company Law.

If the directors, supervisors or senior managers of a PRC company abuse their powers or rights and this results in losses to their company, such directors, supervisors and senior managers will be obliged to indemnify the company from all losses incurred. For instance, if a director of a PRC company has certain specific interests in another company to which security will be provided by the PRC company, and he/she votes in favour of the provision of such security by such PRC company at the board meeting for the benefit of his/her own interests, and, later, the PRC company suffers a loss arising from its provision of such security, the director may be found liable for such loss by a PRC court. However, the law does not clearly stipulate what constitutes an act of abuse and how to quantify the loss suffered by the PRC company; it is, therefore, PRC court's sole discretion.

When considering providing Financial Assistance in the acquisition of a PRC company's equity interests or equity interests in its holding company, the directors of the PRC company shall:

(a) check and ensure that they are not an interested party in such Financial Assistance; and

(b) if the guarantee/security is granted to guarantee or secure the debts of its shareholders, ensure that shareholders' approval is obtained in accordance with Article 16 of the PRC Company Law (see the answer to Question 1 above).

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarisation, registration, government approval, etc.)? Is any tax or duty payable on grants of security and, if so, what is the basis for calculation?

Types of security

The most typical types of security that can be granted over property in China include:

(a) mortgage over real property (land use right, buildings and buildings under construction);

(b) mortgage over equipment;

(c) pledge over equity interests (the "**Equity Pledge**");

(d) floating mortgage over present and future raw materials and semi-finished or finished products; and

(e) pledge over receivables.

Legal concerns relating to granting upstream Foreign Security in a global LBO context

In the context of a global leveraged buy-out under which the acquirer (borrower) is located outside China and the target group comprising subsidiaries incorporated in China:

(a) such PRC subsidiaries are foreign-invested enterprises (i.e. PRC companies with participation of foreign investors which are either wholly foreign-owned enterprises ("**WFOEs**"), i.e. 100% owned by foreign investors, or Sino-foreign joint venture companies, i.e. owned by foreign investors and Chinese parties jointly); and

(b) any guarantee or security to be granted by a PRC subsidiary for the acquisition facility available to the acquirer will be considered as guarantee or security granted to Foreign Parties (the "**Foreign Security**"), assuming that the lenders of the offshore acquisition facility are located outside China. As a result of this, it should be noted that:

(i) Since China administers a strict foreign exchange control policy, the provision of any Foreign Security is subject to the approval from and/or registration with the State Administration of Foreign Exchange ("**SAFE**"), which is the exchange control authority in China.

(ii) Unless the security provider is:

- a WFOE (Article 8 of the Administration of the Provision of Security to Foreign Entities by Domestic Institutions inside China Procedures Implementing Rules, effective 1 January 1998 (the "**Security to Foreign Entities Implementing Rules**")); or

- a foreign-invested enterprise (FIE) which grants Foreign Security for its own obligations[1] (see Articles 27 and 35 of the Security to Foreign Entities Implementing Rules),

1 In a global LBO, this is usually not the case, as the borrower is always the offshore acquirer or offshore target holding company unless the LBO also provides for working capital facilities to local target subsidiaries; in that case, the PRC target subsidiaries are:

(1) Sino-foreign joint ventures that can grant Foreign Security for their own obligations for such working capital facility available to them, (We believe this is a rare case in practice); and

(2) WFOE presumably may grant Foreign Security **but for** the reasons set out in paragraph B(b)(iv) above.

the granting of Foreign Security is subject to the SAFE approval on a case-by-case basis.

(iii) Whether or not the security provider is a WFOE, the security provider shall register the Foreign Security with the local branch of SAFE within 15 days after execution of the relevant security document.

(iv) Even if the Foreign Security granted by a WFOE does not require approval from SAFE, Article 6 of the Security to Foreign Entities Implementing Rules requires that the secured party of a Foreign Security (i.e. the borrower or the person(s) whose debt is secured by such Foreign Security) shall be either:

- a domestic enterprise (i.e. enterprise without foreign investor participation) in China (the "**Domestic Enterprise**");
- a FIE;
- any company incorporated outside China which is a wholly owned subsidiary of a PRC company[2]; and
- enterprises in which there is equity participation from Chinese parties.

Hence, in the context of a global LBO, PRC subsidiaries (whether WFOEs or other FIEs) are unable to give Foreign Security to secure the acquisition facility of their offshore acquirer or offshore target holding company. Usually, the only PRC security that the LBO lenders can have is the Equity Pledge granted by the offshore direct shareholder of the PRC subsidiary over its equity interests in that PRC subsidiary. However, only the paid-up portion of the capital contribution of such offshore shareholder may be pledged.

2 In a global LBO context, this is usually the reverse case (i.e. the PRC company is often the operating subsidiary of the target holding company located outside China).

Perfection of equity pledge

We summarise the types of security, their legal limitations and the approval and/or registration requirements in the table appended to this paper.

Equity Pledge over equity interests in an FIE is required to be:

(a) approved by the original approval and examination authority in relation to the initial establishment of that FIE, which is likely to be the local branch of the Ministry of Commerce or its other authorised local authority (the "**Original Approval Authority**");

(b) filed with the local bureau of the State Administration of Industry and Commerce (local SAIC) within 30 days of obtaining the approval referred to in paragraph (a) above; and

(c) recorded in the FIE's register of shareholders.

There is no statutory time frame or deadline as to when the Equity Pledge is required to be submitted to the Original Approval Authority. However, it is in the interest of all parties to obtain approval and proceed with filing as soon as possible, since an unapproved and unfiled Equity Pledge is invalid under Article 12 of Changes of Equity Interest of Investors in FIE Several Provisions, effective 28 May 1997. The Original Approval Authority must decide whether or not to grant approval within 30 days of the submission of the relevant documents. The FIE is responsible for obtaining such approval and filing process.

In practice, obtaining approval from the Original Approval Authority is generally feasible although the time frame varies from one city to another. The approval process could be a few days or a few months depending on the effectiveness of communication between the relevant FIE and its Original Approval Authority.

Tax/Duty

No stamp duty or tax will be payable on execution or enforcement of the security discussed in Part A above, except that (a) when the mortgaged real property/equipment or other assets or pledged shares/equity or other assets are transferred as a result of the enforcement, stamp duty will be imposed on the parties (buyer and seller) at a rate of 0.05% of the purchase price of the assets as stipulated in the relevant contracts; and (b) deed tax will be imposed on the buyer when the mortgaged real property is transferred as a result of the enforcement at a rate of 3% to 5% (depending on the location of the real property) of the purchase price of the transferred real property.

In addition, registration fees and/or notarisation fees will be charged by registration authorities and/or notarisation offices, subject to local requirements.

4. How long, following acquisition of a foreign target company, would it usually take in China for a local subsidiary of such company to grant a guarantee/ security?

Timing usually depends on the complexity of the financing and security structure and may also vary for different types of security and their different localities. Generally speaking, after execution of the transaction documents, four to six weeks is reasonable for collecting all supporting documents and submitting them to the authorities for registration. However, if governmental approval is required for the granting of security, the whole procedure may take two to three months.

5. Are there any restrictions on foreign banks lending to companies in China? Are interest payments to foreign banks typically subject to withholding tax?

Foreign debt

RMB is not freely convertible to other currencies.

Foreign banks, being entities located outside China, may only lend foreign currency loans to companies incorporated in China, and such loans are considered as 'foreign debts' under PRC law.

Under the current foreign exchange control regime in China, payment and receipt of foreign exchange are divided into two categories: (a) 'capital account items' for capital and debt-related fund flow, such as direct investment and foreign exchange loans from foreign entities, and (b) 'current account items' for trade and service-related fund flow. Cross border fund flow of capital account items is closely monitored by SAFE, and in most cases, SAFE approval, verification and/or registration are required.

A loan granted by a foreign bank located outside China to a PRC company will be categorised as a foreign debt of such PRC company. Accordingly, the PRC borrower is required to:

(a) effect foreign debt registration with the local branch of SAFE within 15 days after entering into the loan agreement. If the loan agreement is not prepared in the Chinese language, a Chinese language summary of the commercial terms of the loan facility is required to be submitted to the local branch of SAFE for registration purposes;

(b) apply for local SAFE approval to open a designated foreign debt account with a bank in China for receiving loan proceeds and making payments under the loan;

(c) file each drawdown, interest payment and principal repayment with local SAFE within five days thereafter; and

(d) apply for local SAFE verification for each interest payment and principal repayment.

Without foreign debt registration, the PRC borrower will not be able to draw down or repay the loan or pay any interest or fee to the offshore lender.

In addition to the SAFE registration requirements as outlined above, if the borrower of foreign debt is:

(a) not an FIE but a Domestic Enterprise which has no Borrowing Gap (as defined in the following pages) or

(b) an FIE with less than 25% foreign participation [*N.B. For the purposes of discussion in the remaining parts of our reply to this Question 5, FIE means FIE with at least 25% foreign participation.*]

prior approval from the local branch of SAFE must be obtained.[3] In case the tenor of the loan to be borrowed is more than one year, such wholly Chinese-owned enterprise is also required to obtain approval from the National Development and Reform Commission ("**NDRC**") in addition to approval from its local SAFE.

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3 Article 7 of the Administration of Taking Out of International Commercial Loans (ICLs) by Organisations in China Procedures (promulgated 24 September 1997) provides that non-financial enterprises taking out foreign debts shall meet the following requirements:

(i) they have produced profits for the past three consecutive years, have been granted permission for import and export business, and are in a line of business that is encouraged by the State;

(ii) they have a sound financial management system;

(iii) for trade-oriented non-financial enterprises, the ratio between net assets and total assets shall not be lower than 15%;

(iv) for non-trade-oriented non-financial enterprises, the ratio between net assets and total assets shall not be lower than 30%;

(v) the sum of foreign debts taken out and the balance of guarantees provided to foreign entities shall not exceed 50% of its net asset value equivalent in foreign exchange; and

(vi) the sum of foreign debts and the balance of guarantees/security in foreign exchange shall not exceed the amount of foreign exchange it generated in the previous year.

In our experience, it is generally not easy for a Domestic Enterprise to satisfy the SAFE requirements for such approval as outlined in footnote 3 of this chapter, and obtain such approvals from local SAFE and NDRC. As a general observation, only large state-owned enterprises have been granted approvals for borrowing foreign debt.

Borrowing gap

The maximum amount that an FIE can borrow from a foreign lender is the Borrowing Gap (as defined below) minus the principal amount of any existing foreign debt(s) registered with the FIE's local SAFE. This is because the total foreign debts borrowed by an FIE should not exceed the Borrowing Gap (see Article 18 of Foreign Debts Administration Procedures, and Section 3 of the SAFE Notice on Improving the Examination of Foreign Exchange Settlement for Capital Items and Registration of Foreign Debt of Foreign-Invested Enterprises, effective 1 July 2004).

The Borrowing Gap is the difference between an FIE's total investment and registered capital. The Borrowing Gap represents the maximum amount that an FIE is permitted to borrow from third parties (including its shareholders) to finance its operations. SAFE will not register a loan agreement relating to foreign debt entered into by the FIE if the amount of the loan facility exceeds the amount of its unutilised Borrowing Gap.

The Borrowing Gap of the FIE may be restored each time its short-term foreign debt (foreign debt with a tenor of no more than one year) is repaid. However, it will be permanently used up by the FIE's incurrence of mid-term and long-term foreign debts (foreign debt with a tenor of more than one year) and will not be reinstated by any repayment of such mid-term and long-term foreign debts.

If the principal amount of the foreign debt to be borrowed by the FIE will exceed its Borrowing Gap, such FIE may increase its total investment so as to increase the Borrowing Gap. However, as a general rule, such FIE's registered capital shall also be increased proportionally because of the proportion requirement on its total investment and registered capital. The chart below shows the proportion requirement on the FIE's total investment and registered capital:

Total investment	Minimum registered capital (% of total investment)
USD 3 million or less	70%
USD 3 million(exclusive) to USD 10 million (inclusive)	50% or USD 2.1 million (whichever is higher)
USD 10 million (exclusive) to USD 30 million (inclusive)	40% or USD 5 million (whichever is higher)
More than USD 30 million	33.3% or USD 12 million (whichever is higher)
Any exception shall be approved by the Ministry of Commerce and the State Administration of Industry and Commerce.	

In addition, while the national law provides that the FIE is able to seek external financings within its Borrowing Gap if its registered capital has been contributed according to the approved payment schedule, in practice, some local branches of SAFE prefer interpreting the rule in a narrow way, which means that where the FIE has yet to make a full contribution of its total approved registered capital, the FIE's Borrowing Gap should be in proportion to its paid-in registered capital.

Withholding tax and business tax

Except as otherwise provided under any applicable double tax treaty between China and the country in which the foreign lender is located, 10% withholding tax and 5% business tax will be imposed on any interest, fees (such as arrangement fees) and commission payable to the foreign lender who is lending through its head office or branch located outside China.

Hence, tax gross-up provisions are always required by the offshore lender in a loan agreement relating to foreign debt. We note that such tax gross-up provision has been effective in ensuring that an offshore lender receives a sum net of any deduction or withholding equal to the sum which it would have received had no such withholding tax been required.

Purpose of the foreign debt

PRC law provides that loan proceeds denominated in foreign currency (whether or not borrowed onshore or offshore) must not be converted into RMB for the repayment or refinancing of its existing RMB loans.

Restriction on currency conversion

As pointed out in Part A above, RMB is not a freely convertible currency. A PRC borrower which has borrowed foreign debts denominated in foreign currency would need to convert RMB funds/revenue at hand into the relevant foreign currency in order to pay interest or fees or repay the principal of the foreign debt denominated in foreign currency.

Such conversion and purchase of foreign currency can be done if:

(a) the foreign debt has been duly registered with local SAFE;

(b) existing foreign currency funds of such company have been used up or are not sufficient for making the requisite payment; and

(c) such repayment is verified by local SAFE. (Verification is just a formality and is relatively easy for the PRC borrower to process.)

Loans lent by PRC branches/WFOE bank of a foreign bank

In the event that a foreign bank lends to a PRC company through (a) one of its branches located in the PRC or (b) its wholly owned subsidiary incorporated in China (the "**WFOE Bank**"), such loan does not constitute foreign debt and is neither required to be registered with local SAFE, nor subject to any PRC withholding tax. However, except for export documentary bills purchased under international trade financing facilities, foreign exchange loan proceeds of such loans lent by the PRC branches of a foreign bank or a WFOE Bank cannot be converted into RMB. Hence, such loans are not an ideal source of working capital, as the borrower can only utilise such loans for offshore uses (e.g. purchasing raw materials or machinery from parties outside China under which payment obligations are denominated in foreign currency).

In the event that a WFOE Bank lends to a PRC company for the purpose of merging with or obtaining control over existing companies as a going concern through acquiring assets or existing equity interests, subscription of newly issued capital or debt restructuring (collectively, the "M&A Loans"), this would be regulated by the M&A Loan Guidelines (as defined in the answer to Question 6).

6. If a takeover bid which relies on bank debt is made for a publicly listed company in China, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Under PRC law, it is specifically provided that a PRC borrower may not use loan proceeds to engage in equity investment except that proceeds of a M&A Loan obtained from an 'eligible lender' may be used for merging with or obtaining control over existing companies as a going concern through acquiring assets or existing equity interests, subscription of newly issued capital or debt restructuring. These are the M&A activities generally described in the M&A Loan Guidelines (as defined below), and takeover of a public listed company will fall within such description. However, if the acquirer will not obtain any controlling position in the target company through such M&A activities, such M&A activities cannot be financed by the eligible lenders pursuant to the M&A Loan Guidelines (as defined below).

On 6 December 2008, the China Banking Regulatory Commission promulgated the Guidelines on Risk Management of Loans extended by Commercial Banks for Mergers and Acquisition (the "M&A Loan Guidelines") to regulate M&A Loans. To address the concern relating to certainty of the availability of bank loan when the takeover bid closes, the lender of the M&A Loan should be a commercial bank incorporated in China[4] which has met the following stringent requirements:

(a) has a capital adequacy ratio of at least 10%;

(b) has a loan loss special reserve of at least 100%;

(c) has a general reserve balance of at least 1% of the loan balance over the same period;

(d) has a comprehensive risk management and effective internal control system; and

(e) has a professional team for credit due diligence and risk assessment.

Also, the M&A Loan shall have a term of not more than five years and the amount of the M&A Loan shall not exceed 50% of the total amount required for such M&A transaction. The M&A Guidelines also require that an M&A Loan has adequate security package, such as equity pledge, mortgage over assets and third party guarantees.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

In general, secured creditors are given priority over equity holders. However, in respect of the enforcement proceeds of security, priority shall be given to payment of the following claims before the secured creditors' claims are satisfied:

(a) enforcement expenses (such as auction fees, etc.);

(b) all applicable taxes in respect of the transfer of the relevant charged assets; and

4 The M&A Loan Guidelines are not applicable to PRC branches of foreign banks, as they are not distinct legal persons.

(c) wages and medical and injury subventions and pensions, and basic pension and medical insurances of staff and workers that are owed by the bankrupt enterprise, and compensation that should be paid to the employee as required by laws and regulations but has not been paid by the bankrupt enterprise before 27 August 2006.[5]

Pursuant to the Enterprise Bankruptcy Law (2007), after the indebtedness to the secured creditors is repaid in priority, the assets of the insolvent enterprise shall be distributed according to the following order:

(a) bankruptcy expenses (including expenses of the bankruptcy proceedings, expenses incurred in the management, sale and distribution of the debtor's assets, and remuneration of officers hired for purposes of the bankruptcy);

(b) debts incurred for the common benefit of the creditors (including (i) debts incurred for the purposes of requesting a counterparty to enter into a contract which had not been performed by either party; (ii) debts arising by law (such as claims for unjust enrichment); (iii) labour and social security costs arising from the continued operation of the debtor's business; (iv) damages caused by the operations of the administrator or related personnel; and (v) damages caused by the debtor's assets);

(c) wages and subsidies for medical treatment and disability, old-age insurance premiums, and medical insurance premiums that shall have been transferred to the employees' personal accounts, as well as compensation for employees as prescribed by the relevant laws and administrative regulations after 27 August 2006 (inclusive);

(d) social insurance premiums and tax fees as defaulted by the bankrupt enterprise other than those prescribed by paragraph (c) above; and

(e) ordinary unsecured creditors.

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5 This is pursuant to the new PRC Enterprise Bankruptcy Law, which was passed on 27 August 2006 and came into effect on 1 June 2007. It is not required to pay such amounts arising after 27 August 2006 prior to the payment of the secured indebtedness, i.e. only the wages, medical claims and pensions that occurred before 27 August 2006 must be paid before the secured creditor could receive any payment.

Where the assets of the bankrupt enterprise are insufficient to pay all the expenses/debts in a certain category in the above order, the assets shall be distributed in proportion to the amount of the expenses/debts owed to the relevant parties in that category.

8. Is interest on debt incurred to acquire a company in China deductible from earnings for tax purposes? Are there any thin capitalisation thresholds?

Interest payments on debts are tax-deductible in China. However, as we discussed in our reply to Question 6, using loan proceeds for capital injection is not allowed under PRC law.

9. Will contractual subordination be honoured by a liquidator or bankruptcy trustee in China?

Contractual subordination is recognised under PRC law.

In general, where an onshore debtor goes into insolvency, unsecured creditors of the debtor will rank equally as mentioned under Question 7. The Enterprise Bankruptcy Law itself does not specifically provide whether contractual subordination (entered into before the PRC company becomes insolvent) will be honoured in the case of insolvency of such PRC company. We expect that:

(a) Given the principle of *pari passu* under the Enterprise Bankruptcy Law, it is likely that subordination arrangements will be upheld by an administrator so long as other unsecured creditors of the debtor that are not party to the subordination arrangements are not adversely affected by the subordination.

(b) Contractual subordination may also be affected by statutory set-off. Article 40 of the Enterprise Bankruptcy Law provides that a creditor may request the bankruptcy administrator to set off a debt owed by an insolvent company against any debts owed by it to the insolvent company.

Article 40 further provides that no set-off shall be allowed if: (i) the debtor of the insolvent company obtained the claim against the insolvent company from a third party after the acceptance of the bankruptcy petition; (ii) the creditor incurred the debt to the insolvent company despite knowing that the insolvent company was insolvent or knowing about the fact of the bankruptcy petition, unless the creditor incurred such debt by law or for reasons which arose one year prior to the bankruptcy petition; or (iii) the debtor of the insolvent company obtained the claim against the insolvent company despite knowing that the insolvent company was insolvent or knowing about the fact of the bankruptcy petition, unless the debtor of the insolvent company obtained such claim by law or for reasons which arose one year prior to the bankruptcy petition.

The provisions regarding set-off after the commencement of bankruptcy proceedings have rarely been tested in the PRC and there appear to be some areas of uncertainty with respect to the interpretation and operation of these provisions. For example, it is not entirely clear whether a bankruptcy administrator will be obliged to allow set-off if all conditions under these provisions are satisfied or whether there are any other criteria a bankruptcy administrator can take into account in rejecting or allowing a set-off.

In a typical contractual subordination, the subordinated creditor usually undertakes not to exercise any rights of set-off it may have against the debtor. However, it remains untested as to whether statutory set-off under Article 40 is mandatory or whether it is possible to contract out of it.

Summary of PRC Security Commonly Taken and Legal Basis

	Basis	**Form**	**Limits**[6]	**Approval**[7]	**Registration**[8]
Land Use Rights	Security Law Art. 34(3) Property Rights Law Art. 180(2)	Mortgage	– Certain properties cannot be mortgaged (e.g. allocated land). – Secured indebtedness cannot be higher than the value of mortgaged property.	– MOC's (or other Original Approval Authority's) approval required if security provider is a WFOE.	– Local land bureau – SAIC registration is required if security provider is a WFOE.
Buildings	Security Law Art. 34(1), (3) Property Rights Law Art. 180(1)	Mortgage	– Same as 'land use rights' above. – Structure on land cannot be mortgaged separately from use right over the land.	– Same as 'land use rights' above.	– Local real estate administration authority – SAIC registration required if security provider is a WFOE
Equipment, machinery and other movables (including products and semi-final products)	Security Law Art. 63	Pledge (where possession passes to pledgee)		– Customs approval is required if equipment is imported.	– Local SAIC <u>possibly</u>

6 In relation to security provided to foreign parties, there are specific restrictions on the amount of secured indebtedness and who the beneficiaries and secured parties can be.

7 In relation to security provided to foreign parties, SAFE approval is required except where the security provider is a WFOE, or where the security provided is for the security provider's own obligations.

8 In relation to security provided to foreign parties, the security agreement should be registered with the local SAFE where the security provider is located.

	Basis	Form	Limits[6]	Approval[7]	Registration[8]
	Security Law Art. 34(2) Property Rights Law Art. 180(4)	Mortgage (where possession does not pass to pledgee)	– Secured indebtedness cannot be higher than the value of mortgaged property.	– MOFTEC's (or other Original Approval Authority's) approval required if security provider is a WFOE. – Customs approval is required if equipment is imported.	– Local SAIC
Receivables	Property Rights Law Art. 223	Pledge			– Credit reference agency
Rights in shares and units in funds	Security Law Art. 75(2) (shares) and Judicial Interpretation Art. 104 (interests and dividends) Property Rights Law Art. 223 (units in funds)	Pledge	– 'Transferable' shares only – For a pledge over capital contribution of the FIE, only 'paid-up portion' can be pledged.	– For a pledge over capital contribution of the FIE, approvals by other investors of the FIE and MOFTEC (or other Original Approval Authority) is required; see para 5.5(c).	– For listed shares and units in funds, registration with the securities registration authority is required. – For non-listed shares, recording in the register of shareholders is required. – For pledge over capital contribution of the FIE or non-trading equity interests, registration with SAIC (or other original registration authority) is required.

Hong Kong

1. Is there any prohibition on a company incorporated in Hong Kong providing Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

There are certain prohibitions on a company incorporated in Hong Kong providing Financial Assistance in connection with the acquisition of shares in itself or its parent company.

Prohibition

Section 47A of the Companies Ordinance (Chapter 32 of the Laws of Hong Kong) (the "**Companies Ordinance**") generally prohibits a company incorporated in Hong Kong from giving Financial Assistance directly or indirectly for the purpose of acquiring shares in that company or its holding company or for the purpose of reducing or discharging liabilities so incurred. The Hong Kong legislation is almost identical to that in England prior to the Companies Act 2006 in England having become effective (the "**Pre-2006 English Law**"). Financial Assistance includes assistance given by way of guarantee, security, indemnity, loan, gift or any other assistance whereby the company's net assets are reduced to a material extent.

Section 47A of the Companies Ordinance applies only to Financial Assistance given by the target or by any of its subsidiaries. Hence, the prohibition does not apply where the assistance is given by a parent in respect of an acquisition of its subsidiary's shares or by a subsidiary to assist in the acquisition of its sister subsidiary's shares. Also, the prohibition applies only to Financial Assistance given by a Hong Kong subsidiary for the acquisition of shares in its Hong Kong holding company.

It does not restrict a Hong Kong subsidiary from giving Financial Assistance for the purpose of an acquisition of shares in its offshore incorporated holding company.

In terms of timing, Section 47A of the Companies Ordinance applies to Financial Assistance given either (a) before or at the same time as the acquisition or (b) to reduce or discharge a liability incurred for the purpose of (i.e. after) the acquisition.

Exceptions

The Companies Ordinance provides that certain specified transactions will not constitute unlawful Financial Assistance (Sections 47C(1) to (4) of the Companies Ordinance). They are:

(a) where the company's principal purpose in giving the assistance is not for the purpose of any acquisition or reducing any relevant liability, or even if the principal purpose of the giving of the assistance was for any acquisition or reducing any relevant liability, it was an "incidental part of some larger purpose" and the assistance is given in good faith in the interests of the company;

(b) a distribution by way of dividend lawfully made;

(c) a distribution made in the course of a company's winding up;

(d) an allotment of bonus shares;

(e) a reduction of capital confirmed by court order under Section 60 of the Companies Ordinance;

(f) a redemption or purchase of shares made in accordance with Sections 49-49S of the Companies Ordinance;

(g) compromises and arrangements under Section 166 of the Companies Ordinance;

(h) certain insolvency arrangements;

(i) the lending of money by the company in the ordinary course of its business where the lending of money is part of the ordinary course of business of the company;

(j) the provision of Financial Assistance for the purposes of an employee's share option scheme; and

(k) loans to employees (other than directors) to purchase shares.

These exceptions are the same as those statutory exceptions available under the Pre-2006 English Law. In practice, the most useful exception in the above list is the "lawful dividend" exception, which enables a purchaser to use funds in the target to assist the purchaser to finance the acquisition to the extent such funds can be extracted as dividend paid by the target. Any such dividend would have to comply with the rules governing the payment of dividends under the Companies Ordinance, and also with the company's articles of association.

Whitewash Procedure

The general prohibition on the giving of Financial Assistance can be relaxed upon compliance with certain prescribed formalities, commonly known as "whitewash" procedures. However, such whitewash relaxation is available only for unlisted companies and, therefore, if the target is a listed company, such company and its subsidiaries can only give Financial Assistance and undergo whitewash after they have been acquired and privatised.

The fundamental requirement of the whitewash procedure is that the company giving the assistance has positive net assets which are not reduced by the giving of Financial Assistance or, to the extent that those assets are reduced, the Financial Assistance is provided out of distributable profits of the company. The Companies Ordinance requires the company to take the following steps to prove compliance with the "net asset" test:

(a) A statement in specified form (Form SC7 or Form SC8) (the "**Director's Statement**") must be completed and signed by (i) the majority of the directors of the company giving the Financial Assistance and (ii) if the shares acquired or to be acquired are shares in its holding company, the directors of that holding company and any intermediate holding companies which are its subsidiaries. The Director's Statement provides that the directors have formed the opinion, as regards the company's initial situation immediately following the date on which the assistance is proposed to be given, that there will be no grounds on which the company could then be found to be unable to pay its debts, and either:

(i) if it is intended to commence winding-up within 12 months of that date, that the company will be able to pay its debts in full within 12 months of the commencement of the winding-up; or

(ii) in any other case, that the company will be able to pay its debts as they fall due during the year following the giving of Financial Assistance.

The Director's Statement must be delivered to the Companies Registry for filing within 15 days after it is signed.

(b) If the company giving the Financial Assistance is not a wholly-owned subsidiary, the members of such company must pass a special resolution approving the giving of the Financial Assistance (Section 47E of the Companies Ordinance). Such special resolution must be passed on the day or within 30 days of the signing of the Director's Statement.

(c) Where Financial Assistance is given by a company in case the acquisition of shares in question is or was an acquisition of shares in its holding company, then that holding company and any intermediate holding company (except where that intermediate holding company is a wholly-owned subsidiary) must also approve the giving of the Financial Assistance by special resolution passed in a general meeting.

(d) In contrast with the Pre-2006 English Law, it is not a statutory requirement in Hong Kong that a report be produced by auditors to the directors of the company giving Financial Assistance stating that they had enquired into the state of affairs of the company and were not aware of anything to indicate that the opinion expressed in the Director's Statement was unreasonable in all the circumstances. Under the Pre-2006 English Law, such auditors' report would be attached to the requisite statutory declaration (which is the equivalent of the Director's Statement). In practice, however, it is advisable that such auditors' report be obtained, as it would (i) constitute independent advice given to both the lenders and directors and (ii) help the lenders in an acquisition finance transaction in their assessment of whether the company would pass the net asset test.

Section 48 of the Companies Ordinance regulates the timing for the giving of Financial Assistance under the whitewash procedure. If a special resolution is required, the assistance must not be given before the expiration of four weeks commencing on the date on which the special resolution (or, if there is more than one such resolution, the last of them) is passed unless the resolution (or resolutions) were passed by all members of the Company.

In any event, the Financial Assistance must be given within three months of the Director's Statement (or the last Director's Statement, if there is more than one).

Criminal and Civil Liability

It is important to note that contravention of Section 47A of the Companies Ordinance constitutes a criminal offence on the part of the company and any officer of the company who is in breach. Contravention may also result in charges of criminal conspiracy.

The Companies Ordinance, however, is silent as to the civil consequences. Although the law on this point is not entirely free from doubt, any transaction in breach of Section 47A is probably void, although it is possible to sever the Financial Assistance from the rest of the transaction. The breach may also give rise to a civil claim by the company for damages, for example, against a director for breach of trust or against a third party in an action for recovery of property from a constructive trustee. The company may also be able to bring a civil claim, in tort, for conspiracy.

The Government has published a consultation paper in which it has proposed a number of changes to the existing provisions on Financial

Assistance in the Companies Ordinance which relate to listed as well as unlisted companies. As an alternative to the proposed changes to the Financial Assistance provisions for private companies, the Government has also asked for views on the abolition of the prohibition on Financial Assistance for private companies (as implemented in the UK following the enactment of the Companies Act 2006). As of this writing, the consultation exercise was still ongoing and the Government was planning to introduce a new Companies Bill into the Legislative Council by the end of 2010.

2. What are the implications under the corporate benefit laws of Hong Kong for a company incorporated in Hong Kong to provide Financial Assistance?

Commercial Benefit

In Hong Kong, directors of a company have a common law duty to act in the best interest of the company, and to exercise powers and take actions that will benefit the company commercially. In addition, the Companies Registry of Hong Kong (the "**Companies Registry**") has also issued non-statutory guidelines that outline the general principles for a director in the performance of his/her functions and exercise of his/her powers, which embody the requirement that the directors should act in the best interest of the company.

When considering providing Financial Assistance for the acquisition of the company's shares or shares in its holding company, directors must decide whether there is any commercial benefit to the company in providing such assistance. The leading authority on the issue of "commercial benefit" is the English Court of Appeal decision in *Rolled Steel Products (Holdings) Limited v. British Steel Corporation* ([1985] 2WLR 908), which courts in Hong Kong will likely follow in determining the circumstances in which a Hong Kong company can give a guarantee or grant security.

Having taken into account that decision and the de facto abolition of the *ultra vires* doctrine in 1997, the relevant law in Hong Kong appears to be as follows:

(a) If the company's memorandum of association has an objects clause (with few exceptions, Hong Kong companies are now no longer required to have an objects clause in their memorandum of association) and it does anything which it is not authorised to do by its memorandum, then such act will no longer automatically be invalid by reason only that it is not authorised by its memorandum (although it appears that such act may still be rendered void on other grounds, where applicable). However, a member of the company may bring proceedings to restrain the company from doing an act which is in breach of its stated objects.

(b) Where a company's memorandum has an objects clause which does not allow the company to give a guarantee or grant security, there is a risk that a guarantee given or security granted will be challenged. Therefore, the company's memorandum of association should be reviewed to ensure that the company is allowed to give a guarantee and grant security. If an amendment to the memorandum of association of the company is necessary, such amendment can be made by the shareholders by way of special resolution and the amendment should be registered with the Companies Registry.

(c) If the company's memorandum of association contains an express authority to give a guarantee or grant security, it is a question of construction in each case as to whether the express authority to give a guarantee or grant security is an "independent object" or a "mere power" ancillary to the main objects. Any "power" should be exercised for purposes reasonably incidental to the "objects" of the company.

(d) Directors have a general duty to act bona fide for the benefit of the company in exercising their powers. One factor that will be taken into account in determining whether the directors are exercising their powers properly is whether the guarantee or security is for the commercial benefit of the company. While commercial benefit is a factual matter in each case, the practical steps that could be taken to reduce the risk of commercial benefit arguments being successfully raised by the most likely objectors (the company's shareholders and creditors) are:

(i) obtaining the unanimous approval of the company's shareholders to the giving of the guarantee or the granting of security (see Section 47E of the Companies Ordinance – under the whitewash procedure, if the company giving the Financial Assistance is not a wholly-owned subsidiary, the members of such company must pass a special resolution approving the giving of the Financial Assistance); and

(ii) obtaining a declaration from the company's directors that the company will not be unable to pay its debts as a result of giving the guarantee or granting security (see Section 47F of the Companies Ordinance – under the whitewash procedure, the directors are required to give the Director's Statement in which they form the opinion that there will be no ground that the company will be unable to pay its debts upon the company's giving Financial Assistance).

(e) If the authority to give a guarantee or grant security is an object (as may be the case for banks and financial institutions), it appears that the issue as discussed in paragraph (b) above would be less significant, but this is not certain. The question will need to be considered with reference to the actual business that the company carries on.

Group Benefit

Further, Hong Kong law generally does not recognise the concept of group benefit. When a parent company gives a guarantee or grants security in respect of a subsidiary's obligations, the commercial benefit to the parent can be clearly established. However, when a subsidiary company gives a guarantee or grants security in respect of its parent's obligations, it is often more difficult to establish what the commercial benefit is to the subsidiary.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarisation, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Types of security

The typical types of security taken in finance transactions over shares and assets in Hong Kong include:

(a) for shares, legal or equitable share mortgages;

(b) for immovable assets, a debenture incorporating fixed charges (which could include a charge over cash in a bank account or an assignment over monies receivable) and floating charges; and

(c) for land, a legal charge over the property.

Technical requirements

Charges over certain assets of a company incorporated in Hong Kong (pursuant to Section 80 of the Companies Ordinance) or a company registered under Part XI of the Companies Ordinance as a non-Hong Kong company (pursuant to Section 91 of the Companies Ordinance) must be registered with the Companies Registry within five weeks of creation of the relevant charge. Failure to register will affect the enforceability of that charge upon the company's liquidation in Hong Kong and the priority of that charge.

The Government has proposed a number of changes to the existing registration provisions. Among others, the Government has proposed to update the list of registrable charges (e.g. expressly providing that a charge on an aircraft or any share in an aircraft would be registrable, removing the requirement to register a charge for the purpose of securing any issue of debentures and excluding charges over cash deposits from the registration requirements) and shortening the registration period to 21 days. As noted above, as of this writing, the consultation exercise was still ongoing and the Government was planning to introduce a new Companies Bill into the Legislative Council by the end of 2010.

Charges over real property must also be registered with the Land Registry of Hong Kong to preserve their priority.

Taxes and duties

No stamp duty or registration or similar taxes or charges are payable under the laws of Hong Kong in respect of the security documents, except that:

(a) if the shares in a Hong Kong company are mortgaged, a nominal stamp duty of HKD5 is payable on the instrument of transfer signed in blank (which is normally required by the lender) being executed and the shares being registered in the name of the lender (or its nominee) to convert an equitable share mortgage into a legal share mortgage. Stamp duty at a rate of 0.2% of the value of shares being transferred will be payable upon the actual enforcement of the security constituted by the share mortgage;

(b) for a company granting a legal charge, a land registration fee of HKD450 is payable to the Land Registry of Hong Kong; and

(c) for a Hong Kong company or a company registered under Part XI of the Companies Ordinance, a registration fee of HKD340 is payable for the registration of each security document registered at the Companies Registry.

4. How long, following acquisition of a foreign target company, would it usually take in Hong Kong for a local subsidiary of such company to grant a guarantee/security?

There is generally no restriction on when a local subsidiary can grant a guarantee or security following the acquisition of a foreign target company. However, if there are Financial Assistance issues and the Hong Kong subsidiary undergoes the whitewash procedure, the quickest period in which the subsidiary can provide the guarantee or security is 21 days from the acquisition. Although there is no statutory prescribed time period for the directors to consider before giving the Director's Statement, the 21 days reflects the typical period for convening an extraordinary general meeting of a company incorporated in Hong Kong. However, in urgent transactions, all the members of the company can consent by way of special resolutions to shorten such notice period. The Financial Assistance can then be provided within four weeks of the date of the special resolution passed by the company. If the Hong Kong company giving the Financial Assistance is a wholly-owned subsidiary and if no special resolution is required, the Financial Assistance can be given when the Director's Statement has been issued and filed with the Companies Registry.

However, in practice, it is often not just the company granting the Financial Assistance that has to carry out whitewash procedures. If the shares acquired or to be acquired are shares in the holding company of the Hong Kong company, the directors of that holding company and any intermediate holding company, must also pass special resolutions of its members, thereby delaying when the Hong Kong company can grant the guarantee or security.

5. Are there any restrictions on foreign banks lending to companies in Hong Kong? Are interest payments to foreign banks typically subject to withholding tax?

Lending regulation

A foreign bank or financial institution lending to a company located in Hong Kong is not subject to any licensing requirements or other regulatory restrictions if the lender is an "authorised institution" ("**AI**") under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong).

There are also currently no regulatory controls over the movement of foreign exchange.

However, a lender to a Hong Kong company which is not a AI should be aware of the Money Lenders Ordinance (Chapter 163 of the Laws of Hong Kong) (the "**Money Lenders Ordinance**"). The Money Lenders Ordinance imposes licensing and other compliance requirements which may apply to a non-AI lender unless (a) the lender falls under one of the categories of "exempted person" that are set out in the Money Lenders Ordinance or (b) the loan falls under one of the "exempted loan" categories listed in the Money Lenders Ordinance. It is not possible to contract out of the Money Lenders Ordinance. "Exempted persons" and lenders of "exempted loans" are exempted from the licensing requirements under the Money Lenders Ordinance and most of its other compliance requirements. They will, however, remain subject to the usury provisions of the Money Lenders Ordinance which, in essence, regulate the charging of excessive interest rates by any person. Under Section 24 of the Money Lenders Ordinance, an effective annual interest rate of 60% is illegal. Also, under Section 25, an effective annual interest rate that is between 48% and 60% is presumed to be extortionate and a Hong Kong court may reopen the underlying transaction accordingly.

A lender to a Hong Kong entity should also be aware of the Partnership Ordinance (Chapter 38 of the Laws of Hong Kong) (the "**Partnership Ordinance**"). According to the Partnership Ordinance, where a loan advance is made at an interest rate that varies with the borrower's profits or where repayment is made by way of a share of the borrower's profits, the lender will be treated as a partner of the borrower (and will be liable as such). In addition, a lender that advances money on these terms may be subordinated to the borrower's other creditors. It is common in Hong Kong for a lender and borrower to agree to contract out of the Partnership Ordinance.

No withholding

Interest, fees or commission payable by a company located in Hong Kong pursuant to a banking facility or a loan are not subject to any withholding tax in Hong Kong.

6. If a takeover bid which relies on bank debt is made for a publicly listed company in Hong Kong, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Takeovers Code

The Code on Takeovers and Mergers (the "**Takeovers Code**") issued by the Securities and Futures Commission of Hong Kong ("**SFC**") applies to take-overs and mergers affecting public companies in Hong Kong and companies with a primary listing of their equity securities in Hong Kong, and imposes (among other things) certain disclosure obligations on the offeror and the offeree in a proposed take-over of a company whose shares are listed on The Stock Exchange of Hong Kong Limited. Such disclosure obligations include the details as to how the takeover is financed.

Disclosure requirement

Rule 3.5 of the Takeovers Code provides that a firm intention to make an offer should be made only when an offeror has "every reason to believe that it can and will continue to be able to implement the offer". The offeror's financial adviser is required to confirm in the announcement that "resources are available to the offeror sufficient to satisfy full acceptance of the offer" (the "**Relevant Statement**"). The financial adviser is expected to observe the highest standard of care to satisfy itself of the adequacy of resources, including performing the requisite due diligence and making due enquiry. The SFC may require evidence in support of the Relevant Statement or that the offeror has sufficient resources to complete the purchase of shares which gives rise to the offer. A similar statement is required in the offer document issued by the offeror in connection with the offer if the offer consists of, or includes, cash or other assets (other than new securities issued by the offeree company).

In addition, the offer document must also contain a description of how the offer is financed and the source of the finance (see paragraph 12(b) of Schedule I to the Takeovers Code) (except for cash offers seeking to privatise the offeree company and without any waiver of the acceptance condition). The principal lenders or arrangers of such finance must be named. Where the offeror intends that the payment of interest on, repayment of or security for any liability (contingent or otherwise) will depend to any significant extent on the business of the offeree company, a description of the arrangements contemplated will be required. Where this is not the case, a negative statement to this effect must be made in the offer document. Further, except with the consent of the Executive, documents relating to such financing arrangements need to be made available for inspection and can be viewed on (among others) the SFC's website (see Notes 1(1) and 2 to Rule 8 of the Takeovers Code).

Many leveraged buyouts require members of the target group to give guarantees and security to the lenders. As a result of the requirements under paragraph 12(b) of Schedule I to the Takeovers Code, the terms and conditions of the security and guarantee arrangements, to the extent given or to be given by such members, should also be disclosed in the offer document.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Order in insolvent liquidation

Section 250 of the Companies Ordinance provides for the general principle of *pari passu* distribution. This means that all debts and claims of the general creditors will rank equally among themselves and, if the property of the company is insufficient to meet them in full, they will be paid proportionately. However, Sections 256 and 265 of the Companies Ordinance provide for situations where certain creditors will be paid ahead of other creditors.

In general, the order of ranking of creditors is:

(a) creditors with security where, absent any intercreditor agreements and arrangements among the secured creditors to the contrary, earlier registered charges take priority over later registered charges (unless the later chargee had notice of the earlier charge);

(b) the expenses of the winding up, including the liquidator's remuneration (Section 256 of the Companies Ordinance (for voluntary liquidation) and Rule 179 of the Companies Winding-up Rules (for compulsory liquidation));

(c) the preferential payments as specified in Section 265 of the Companies Ordinance;

(d) creditors with floating charges (Section 265(3B) of the Companies Ordinance);

(e) any preferential charge on goods distrained that arises under Section 265(5A) of the Companies Ordinance;

(f) the company's general unsecured creditors;

(g) interest on debts in paragraphs (c) to (e) above (which rank equally) outstanding for the period after the company went into liquidation (Section 264A of the Companies Ordinance);

(h) any debts or other sums due from the company to its members as members (known as "deferred debts" under Section 170(1)(g)); and

(i) the members generally in accordance with their respective rights and interests (Section 250 of the Companies Ordinance).

8. Is interest on debt incurred to acquire a company in Hong Kong deductible from earning for tax purposes? Are there any thin capitalisation thresholds?

Interest is only deductible in Hong Kong if it is incurred for the purposes of producing assessable profits and meets one of a number of specified conditions. Interest paid on debt incurred for the purposes of acquiring shares (from which non-assessable dividend income will be derived) is not tax-deductible. On the other hand, share traders (e.g. some venture capital and private equity funds) which carry on business in Hong Kong should be allowed a tax deduction for interest used for acquiring shares on the basis that they will be taxable in Hong Kong on the Hong Kong sourced profits associated with the subsequent disposal.

It is purely a commercial decision for a lender as to whether it should lend to a thinly capitalised Hong Kong company. There are no thin capitalisation restrictions for Hong Kong tax purposes.

9. Will contractual subordination be honoured by a liquidator or bankruptcy trustee in Hong Kong?

Under a typical contractual subordination, the senior and subordinated creditors will agree that the subordinated creditor will not exercise its rights in respect of the relevant debt until the senior creditor has been paid in full. The validity of such subordination might be called into question upon the liquidation of the company, since in the liquidation of a company, creditors (other than creditors having security or a statutory priority) will rank *pari passu* on the winding up of such company.

In deciding whether to honour a contractual subordination, a liquidator will, to a minimum, need to consider:

(a) whether doing so would prejudice or adversely affect the rights of other creditors of that subordinated creditor who are not parties to the subordinated arrangement (*Re Maxwell Communications Corp plc (No. 2)* (1993) Chancery Division); and

(b) the statutory set-off provision contained in Section 35 of the Bankruptcy Ordinance (Chapter 6 of the Laws of Hong Kong), as applied by Section 264 of the Companies Ordinance.

Section 35 of the Bankruptcy Ordinance provides that if, before the company goes into liquidation, there have been mutual credits, mutual debts and other mutual dealings between the company and any creditor, an account shall be taken of what is due from each party to the other in respect of the mutual dealings and the sums due from one party shall be set off against the sums due from the other.

The rules of insolvency set-off under Section 35 of the Bankruptcy Ordinance are mandatory (*National Westminster Bank Ltd v. Halesowen Presswork and Assemblies Ltd.* (1972)). Hence, Section 35 poses a potential difficulty in the context of subordinated debt arrangements. In a typical subordination agreement, the senior creditor will require the subordinated creditor not to exercise any rights of set-off that the subordinated creditor may have against the debtor, in order to ensure that part of the subordinated debt is not repaid before the senior debt is repaid. Since it is not possible to contract out of the statutory provisions, it is therefore common for subordination agreements to have a clause to require the subordinated creditor to prove for the full amount of its claims in respect of its subordinated debt and then apply any amount paid to it in respect of such subordinated debt in satisfaction of the senior debt until such senior debt is repaid in full.

While the law in Hong Kong, as the case in England, remains subject to uncertainties, recent case law has provided some welcome clarification with respect to the validity of contractual subordination arrangements in which a creditor agrees to waive, postpone or subordinate its debt on insolvency to the debts of other creditors.

Indonesia

1. Is there any prohibition on a company incorporated in Indonesia providing Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

Subject to the corporate benefit principle, there is no statutory prohibition on a company incorporated in Indonesia to provide Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate). In case there are minority shareholders, there are protection provisions under the Company Law and Securities Law.

2. What are the implications under the corporate benefit laws of Indonesia for a company providing Financial Assistance?

The Indonesian Company Law requires that the business operations of a limited liability company be carried out in accordance with the company's objectives and purposes as specified in the company's articles of association. In our view, the capacity of a company to enter into an agreement is not limited to the language of the objectives and purposes clauses but will also include entering into an agreement that facilitates business opportunities or financing opportunities to achieve its business purposes and objectives. The court, based on factual circumstances, will determine the validity of this argument. Although not necessary, specific reference in the corporate approvals (such as in the board of commissioners' approval and the general meeting of shareholders' approval) may strengthen the evidence of corporate benefit.

As regards the duty of the directors, the Indonesian Company Law provides that each member of the board of directors must undertake his/her duties in good faith and with full responsibility for the interests and business of the company. While the duty of good faith is not elaborated further by the Company Law, in practice, one of the principles that generally applies is the principle of 'corporate benefit'. In this regard, a director must act only in what he/she considers in the best interests of the company.

To minimise the issue of corporate benefit, boards of the company and its shareholders should pass resolutions to 'whitewash' the corporate benefit issues. However, it should be noted that the Company law provides provisions on lifting the corporate veil whereby the company's shareholders could be personally liable for any contract entered into on behalf of the company and for the company's losses in excess of the value of the shares that they have subscribed for if, among others, the shareholder concerned, either directly or indirectly, has in bad faith misused the company solely for its own personal interests; or the shareholder concerned, both directly and indirectly has used the company's assets unlawfully, causing the company's assets to become insufficient for the settlement of the company's liabilities.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarisation, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The types of security typically granted over shares and assets under Indonesian laws are as follows:

(a) for shares, pledge over shares;

(b) for other movable property, pledge or fiducia security; and

(c) for immovable property, mortgage (*Hak Tanggungan*).

Pledge

Pledges are governed under Article 1150-1160 of the Indonesian Civil Code and are defined as a right obtained by a creditor over movable goods that is delivered by the debtor or third party acting on behalf of the debtor as security against the debtor's indebtedness. A pledge gives the creditor preferential right over other creditors to satisfy the claims against the debtor out of the proceeds of sale of the goods.

The establishment of a pledge depends on the nature of the goods. A pledge of tangible movable goods and bearer instruments is established by the delivery of the goods into the actual possession of the pledgee or a third party agreed upon by the parties.

A pledge over shares is established by entering into a pledge agreement (which may be in English) and such pledge must be notified to and accepted by the company, and this would normally be evidenced by an annotation in the company's share register book.

Fiducia security

Fiducia security is a security right securing repayment of a debt over (a) tangible or intangible movable goods; and (b) immovable goods which cannot be the subject of *Hak Tanggungan* and are still in the possession of the grantor of the fiducia security. This security right will grant the secured party priority right over other creditors.

The Fiducia Security Law requires a fiducia agreement to be executed in Bahasa Indonesia in the form of a notarial deed. The first priority security interest of the fiducia security will be established upon registration of the fiducia security at the Fiducia Registration Office where the fiducia grantor is domiciled. The Fiducia Registration Office will register the fiducia security in the Registration Book of Fiducia Security on *the same day* the application is accepted by the Fiducia Registration Office. Thereafter, the Fiducia Registration Office will issue a Certificate of Fiducia on the same day of the registration.

Hak Tanggungan

Hak Tanggungan is documented in a deed of *Hak Tanggungan* drawn before a Land Deed Official ("*Pejabat Pembuat Akta Tanah*" or PPAT), who in most cases is a public notary as well. The grantor of *Hak Tanggungan* (being the legal owner of the land) and the security holder are the parties to this deed. PPAT is obliged to register *Hak Tanggungan* within seven days from the signing of the deed of *Hak Tanggungan* at the National Land Agency ("*Badan Pertanahan Nasional*" or BPN) and *Hak Tanggungan* will be registered in the land book at BPN on the seventh day after BPN receives the complete application for the registration of *Hak Tanggungan*. The first priority security interest will be created on the date of registration by BPN.

Stamp duty

Under Indonesian taxation laws, stamp duty shall be imposed for certain types of documents. Stamp duty will be imposed at a nominal value of IDR 6,000 (approximately USD 0.65) per document, regardless of the value of the transaction. Technically, in case the relevant document is executed outside Indonesia, the stamp duty is due only at the time the document is used or submitted to the courts in Indonesia.

4. How long, following acquisition of a foreign target company, would it usually take in Indonesia for a local subsidiary of such company to grant a guarantee/security?

In order to ascertain the corporate authority of an Indonesian company to grant a guarantee or security, the company's articles of association should be reviewed. Generally, the articles of association require the directors to obtain prior written approval from the board of commissioners (and from the shareholders) of certain corporate actions involving granting of security or becoming a guarantor. The absence of a proper corporate authority could render the agreement void.

Under the Indonesian Company Law, it is mandatory that shareholders' approval is obtained for the transfer and encumbrance of assets of the company with a value of more than 50% of the company's net assets. The general meeting of shareholders must approve this corporate action with a quorum of at least three quarters of the total number of issued shares with valid voting rights and the vote of three quarters of the number of votes cast.

The Indonesian Company Law requires that before convening a general meeting of shareholders, invitation to the shareholders must be delivered at least 16 days prior to the scheduled meeting date. However, the above will not apply if the meeting is attended by all shareholders and the resolutions are approved by all shareholders.

If the company is a public company, then certain requirements for procedure to convene a shareholders' meeting will apply, including the requirement to announce the plan to convene the general meeting of shareholders at least 14 days prior to the notice of the general meeting of shareholders (which, as mentioned in the previous paragraph, is to be made by the company at least 16 days prior to the scheduled meeting date).

5. Are there any restrictions on foreign banks lending to companies in Indonesia? Are interest payments to foreign banks typically subject to withholding tax?

Currently, there are no restrictions on foreign banks lending to companies in Indonesia.

Interest payments and withholding tax

Interest payments to foreign banks (offshore entities) are typically subject to withholding tax. The withholding tax rate on interest paid by a resident taxpayer to non-resident taxpayers (provided that the payment is not effectively connected with a permanent establishment that the recipient has in Indonesia) is 20%. This is a final withholding tax. However, if the interest is paid to a party that is a tax resident of a country with which Indonesia has a tax treaty in force, the withholding tax rate may be lower. Under most of the Indonesian tax treaties, the withholding tax rate on interest payment is reduced to 15%, 10% or 5%, depending on the applicable tax treaty. Under some of the Indonesian tax treaties, the lower rate will be applicable only if the recipient is the beneficial owner of the interest.

6. If a takeover bid which relies on bank debt is made for a publicly listed company in Indonesia, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

A takeover of a publicly listed company is defined as an action directly or indirectly causing changes to the controller(s) of the company. The controller of a publicly listed company is defined as a party (or parties) that:

(a) owns more than 50% of the paid-up capital; or

(b) has the ability to control, with whatever means, the management and/or the policies of the target company, directly or indirectly.

Unless a takeover falls under the exemption, it must be followed by a Tender Offer for all the remaining shares.

Under Bapepam Rule No. IX.F.1, attachment to Bapepam Decree No. KEP-04/PM/2002 dated 3 April 2002, the party that intends to make a Tender Offer must announce the Tender Offer plan in at least two Indonesian daily newspapers, one of which has nationwide circulation. The announcement must include, among others, a statement by an independent accountant, bank or underwriter, that the party 'has adequate funds' to finance the Tender Offer.

As regards the acquisition of an Indonesian bank, under the prevailing laws, a bank acquisition must not use any financing (in whatever form) from a bank or other parties in Indonesia.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

As governed under Article 189 of the Bankruptcy Law, the curator must draw up a list for distribution for approval by the supervisory judge. The list for the distribution contains details of receipts and expenditures, including recompenses for the curator, names of creditors, the amount of each claim verified, and the portion to be received by creditors.

Basically, under the prevailing laws, the order of priority in insolvent liquidation is as follows:

(a) claims given priority under Article 1149 of the Indonesian Civil Code, i.e. (i) legal charges exclusively caused by sale and saving of the estate (the Civil Code states that these shall have priority over pledges and mortgages); and (ii) costs and expenses incurred in preserving the property of the company;

(b) tax obligations of the company, which include all principal tax and administrative sanctions (in the form of interest, fines, increase and cost of tax collection);

(c) secured creditor (with securities such as pledge, fiducia security and *Hak Tanggungan*);

(d) other unsecured creditors given priority under Article 1149 of the Indonesian Civil Code, which include laborers' wages during the last year and those which are due for the current year, including the amount of any raise of such wage; and

(e) ordinary unsecured creditors.

Under the Indonesian Company Law, debt holders are given priority over equity holders.

8. Is interest on debt incurred to acquire a company in Indonesia deductible from earnings for tax purposes? Are there any thin capitalisation thresholds?

Interest

Interest is deductible, and the withholding tax will be payable on the basis of when the interest is due or paid, whichever occurs first.

Thin capitalisation

The Tax law authorises the Minister of Finance to determine the debt to equity ratio of an Indonesian company for the purpose of determining its tax liability but, to date, there are no specific decrees in force to deal with this matter.

The Directorate General of Taxation has the authority to restipulate loans as equity in situations where loans have been made to an Indonesian company by a party with which the Indonesian company has a special relationship. This allows the Indonesian tax authority to handle such issues on a case-by-case basis.

9. Will contractual subordination be honoured by a liquidator or bankruptcy trustee in Indonesia?

Yes. Bankruptcy law does not mean nullifying existing contractual arrangements.

Under the Bankruptcy law, the curator has the right to revisit all of the contractual arrangements made by the debtor. Basically, the curator will honour the arrangement made by the debtor unless such arrangement is considered not in the best interests of the bankruptcy estate.

Japan

1. Is there any prohibition on a company incorporated in Japan providing Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

Under Japanese law, there is no direct prohibition against a company providing Financial Assistance in connection with the acquisition of shares in itself or its parent company. A company may theoretically provide Financial Assistance (i.e. loans, guarantees or security) in connection with the acquisition of its shares or its parent company's shares. In practice, however, a target company will not provide any Financial Assistance to the acquirer unless and until it is wholly owned by one or more shareholders, each of whom is a party to the acquisition (see Question 2 below). If a subsidiary of the target company is wholly owned by its parent company at the time of the share purchase, that subsidiary may provide Financial Assistance concurrently with the acquisition. If the target company is owned by more than one shareholder and most shareholders are party to the share purchase transaction(s) (including in the case of a TOB), neither the target company nor its subsidiaries will provide Financial Assistance until the completion of squeeze-out procedures.

2. What are the implications under the corporate benefit laws of Japan for a company providing Financial Assistance?

Under Japanese law, the concept of corporate benefit relates to the "duty of care" or "duty of loyalty" of the directors provided under Article 330 of the Corporations Law, which stipulates that directors are required to act for the benefit of the corporation. Since the ultimate beneficiaries of the corporation are its shareholders, it is generally understood that any actions which do not harm the interests of the shareholders will not violate the duty of care and duty of loyalty. There is an argument that the directors' duty of care/loyalty should also be owed to the creditors of the company but, as creditors are protected in other ways (i.e. creditors under Japanese law may apply to have prejudicial or fraudulent transactions set aside), this argument has not gained much traction.

Accordingly, a target company will not, in practice, provide Financial Assistance where only some of its shareholders are selling their shares. If a target company were to provide Financial Assistance for a sale of less than all of its shares, such a transaction would prejudice those shareholders who do not sell their shares and would, as such, constitute a violation of the directors' duty of care/loyalty. In such case, any Financial Assistance would only be provided after all of the target company's shares have been acquired by the acquirer.

Conversely, if each of the target company's shareholders is party to the share purchase transaction, then the target company may provide Financial Assistance concurrently with the acquisition, as such Financial Assistance will not prejudice any of its shareholders.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarisation, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The security package in connection with acquisition finance in Japan generally includes all assets owned by the target company and all shares issued by the target company and the acquirer.

However, as Japanese law does not have the concept of a floating charge, a security interest needs to be established separately for each asset. The basic security package for an acquisition finance transaction commonly includes the following:

Share Pledges over the target company (including its subsidiaries) and the acquirer (typically an acquisition SPV)

Under the Corporations Law, an unlisted company may, in its articles of incorporation, choose whether it issues physical share certificates.

(a) Physical share certificates issued

If share certificates are issued, the pledge is established by:

(i) an agreement between parties, and

(ii) physical delivery of the share certificates to the pledgee (Article 146-2 of the Corporations Law). The share pledge is perfected by the pledgee's continuous possession of the share certificates (Article 147-2 of the Corporations Law).

(b) No physical share certificates issued

If the company does not issue share certificates in accordance with its articles of incorporation, the pledge is established by:

(i) an agreement between parties, and

(ii) registration on the shareholders' register maintained by the issuing company (in most cases, a trust bank is appointed as a Shareholders' Register Agent to maintain the register on behalf of the issuing company).

Lenders generally require the issuance of share certificates when establishing a pledge over the shares to ensure their control of any subsequent transactions in the shares, which may require amendment of the target company's articles of incorporation.

(c) Dematerialised shares

Transactions involving the shares of a listed company are conducted through a book-entry system such as the one maintained by the Japan Securities Depository Center Inc. ("**JASDEC**"). Under this book-entry system, system participants such as security firms and banks (each a "**Custodian**") deposit their customers' stocks or other securities in JASDEC on the basis of a custody arrangement. The delivery of dematerialised securities in connection with a transfer, pledge or security assignment is processed by book-entry transfers between customer accounts maintained by the Custodian and/or the participant accounts maintained at JASDEC (i.e. no physical delivery is made). The shares of the target company will be transferred to the purchaser's account at the Custodian through this book-entry system. The Law Concerning Clearance of Bonds and Stocks, Etc. provides that a pledge over shares can be created by an agreement between the parties, and the transfer of the shares to the pledge sub-account of the pledgee at the Custodian. Where there are multiple pledgees however (as is the case in most acquisition finance transactions), the relevant account must be in the name of each of the pledgees for the pledge to operate in favour of each of the pledgees. In the alternative, a security trustee structure can be put in place and the account would be solely in the name of the security trustee. In practice, the security trustee structure has yet to gain popularity due to time and cost considerations.

The dematerialisation of listed shares became mandatory as of 5 January 2009, and physical delivery of share certificates in relation to listed shares is no longer possible.

Bank account pledges

Lenders in Japan often demand that the borrower and the target company open bank accounts with a member of the loan syndicate and that the business use such accounts exclusively. The reasons for this are the following:

(a) the lenders prefer to have control over the target's accounts and use them to monitor the target's cash flow;

(b) the lenders may be able to set off any obligations owing to the borrower; and

(c) it may be difficult to establish security over bank accounts held at other banks and any funds in those accounts could be subject to set-off by that account bank. In order to establish a pledge over a bank account, you need (x) an agreement between parties and (y) the date-certified written consent of the account bank (date certification is done by a notary public and is required for perfection).

Security assignment over present and future receivables of the target company (including its subsidiaries)

While the security assignment concept does not exist under the Japanese Civil Code, its use has been acknowledged by the Japanese courts and it is an important tool for creating security in Japan. A security assignment is created by transferring the underlying assets (in this case, receivables) pursuant to a security assignment agreement. However, if the agreement giving rise to the receivables prohibits the assignment of such receivables then the agreement must, if possible, be amended to allow the security assignment.

The leading case regarding whether future receivables can be assigned is a Supreme Court decision handed down on 29 January 1999. The Japanese Supreme Court determined in that case that future receivables may be assigned to the extent that the receivables subject to assignment are appropriately specified.

There are three options for perfecting a security assignment over receivables:

(a) date-certified notice to the underlying obligor (generally delivered by certified mail),

(b) obtaining the date-certified consent of the underlying obligor, or

(c) registration of the assignment at the Legal Affairs Bureau.

One or more of the options may be used depending on the circumstances. If the target is providing a security interest over an inter-company loan, option (b) (consent) is ordinarily selected. On the other hand, since perfection under options (a) and (b) require notice to or consent from each underlying obligor, option (c) is generally used where there are a large number of underlying obligors. Please note, however, that registration of the assignment only perfects the assignment against third parties. Registration does not perfect the assignment against the underlying obligors, and notice to the underlying obligors will therefore still be required for enforcement purposes if option (c) is selected.

Security assignment over movable assets

A security assignment over movable assets is established by an agreement between parties and perfected either by delivery of the movable assets to the secured party or registration of the security assignment at the Legal Affairs Bureau. Delivery of the movable assets includes "conceptual delivery". Physical delivery of the assets is not required if the parties agree that the security provider has "delivered" the underlying assets but retains them on behalf of the secured parties.

Prospective purchasers are not required to enquire as to whether a security interest has been registered in respect of an asset they wish to purchase. As such, registration is not often used in practice because the effect of the registration is no different from delivery of the assets and will not protect the secured parties from a bona fide purchaser acquiring the assets.

In order to avoid a possible sale of the assets to a bona fide purchaser, the lenders will sometimes demand that the security provider put labels/plaques on the assets to show that they are subject to the security assignment.

Mortgage over the real estate of the target company (including its subsidiaries)

A mortgage is established by an agreement between parties and must be registered at the Legal Affairs Bureau to be perfected. The mortgage must be registered at each local Legal Affairs Bureau in which the subject property is located. The application for registration is made by both parties to the mortgage, generally through a qualified judicial scrivener acting on behalf of both parties. A registration tax of 0.4% of the secured obligation (i.e. principal amount of the loan) is assessed on the initial registration, and a nominal charge will apply to any subsequent registrations securing the same obligations.

Due to the registration tax, a mortgage is sometimes only registered on a provisional basis until such time as a specified event (such as a default) occurs. Provisional registration of a mortgage involves only nominal costs and preserves the priority of the mortgagee as of the time in which such provisional registration is applied for, but the provisional registration must be converted to a full registration (and the registration tax paid) prior to any enforcement of the mortgage. Full registration is therefore preferable to lenders, but the choice between provisional and full registration often depends on the relative bargaining position of the parties.

Real estate and any movable assets ancillary thereto in connection with a factory or other facility specified under the various "Foundation Mortgage" laws may be registered as a single package of assets for the purpose of creating a mortgage over such assets.

4. How long, following acquisition of a foreign target company, would it usually take in Japan for a local subsidiary of such company to grant a guarantee/ security?

There is no statutory waiting period following the acquisition of a foreign parent company in relation to the provision of security by its Japanese subsidiaries. Therefore, the Japanese subsidiaries of the foreign parent may provide such guarantee/security immediately upon completion of the acquisition and the borrower obtaining control of the Japanese subsidiaries. Registration of security interests with the Legal Affairs Bureau generally takes approximately one or two weeks to complete but the perfection of the security interests is deemed to occur as of the time of the application for registration rather than on completion thereof.

5. Are there any restrictions on foreign banks lending to companies in Japan? Are interest payments to foreign banks typically subject to withholding tax?

A money lending business licence (or banking licence) is required if a person (including legal entities) is to be engaged in the business of providing loans in Japan. Generally, foreign banks which conduct business in Japan have obtained a Foreign Bank Branch Licence under the Banking Law and may provide loans to companies in Japan under such licence. If the foreign bank is providing only the one loan in Japan, an argument can be made that such lending will not fall within the definition of a "business" and they should therefore not be required to obtain the relevant licence. However, to the extent the loan is made by a foreign bank (which generally provides loans as part of its business), such argument is unlikely to succeed and the relevant licence under the Money Lending Business Law or Banking Law will generally be required.

A withholding tax of 20%, subject to any tax treaties, will be applied to any interest payments made to foreign jurisdictions.

6. If a takeover bid which relies on bank debt is made for a publicly listed company in Japan, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

A person who intends to acquire shares via a takeover bid (TOB) shall submit the TOB Application to the Local Finance Bureau (Article 27-3.2 of the Financial Instrumental and Exchange Law (FIEL)). At the time the TOB Application is submitted, the acquirer must also submit evidence it has sufficient funds available to purchase any shares offered in response to the TOB. Where the acquirer uses financing from banks, they must submit a Certificate of Funds based on the commitment letter issued by the banks. The Certificate of Funds must include a summary of the conditions precedent to funding and, by extension, the conditions precedent to funding must therefore be agreed prior to filing the TOB

Application. The commitment letter generally contains the basic terms and conditions of the loan. It is not necessary for the loan agreement to be executed on or prior to the submission of the TOB Application. In practice, the loan agreement continues to be negotiated even after submission of the TOB Application and is executed a couple of days prior to the end of the TOB offer period of between 20 and 60 days, as determined by the acquirer and set out in the TOB Application.

If the bank does not provide the loan to the acquirer despite the success of the TOB, the bank may be liable for breach of the commitment letter. The liability for such breach depends upon the extent to which the banks have committed to providing the loan and the terms and conditions thereof. Although most commitment letters contain a disclaimer of liability by the banks, in the event a final loan agreement is not reached by the parties, banks will, in practice, almost certainly provide the loan once they have submitted the Certificate of Funds due to the potential impact on shareholders and the reputational risk to the banks.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

The priority between debt holders and equity holders is stipulated in Article 502 of the Corporation Law. Under Article 502, the company cannot distribute the residual value of its assets unless the company has paid its debts in full. Accordingly, debt holders shall be paid prior to equity holders in the event of an insolvent liquidation of the company.

Secured creditors may exercise their security interests outside the insolvency liquidation procedure. Secured creditors will, in this manner, generally enjoy priority over unsecured creditors (see Question 9).

8. Is interest on debt incurred to acquire a company in Japan deductible from earnings for tax purposes? Are there any thin capitalisation thresholds?

Interest payments on debt used to fund an acquisition are tax-deductible in Japan.

There are thin capitalisation rules which limit interest payment deductions for companies in Japan which are leveraged in excess of certain thresholds. The rules apply only to foreign-owned Japanese companies which raise funds from its foreign controlling shareholders or third parties related to its foreign controlling shareholders.

Under the rules, broadly, interest payments are excluded from a company's deductible expenses to the extent such interest payments relate to debt owed to its foreign controlling shareholders and/or third parties related to its foreign controlling shareholders and to the extent such debt exceeds three times the company's net equity. Alternatively, a company has the option of using a reasonable debt-equity ratio for a comparable Japanese company which operates a similar business and has similar characteristics (i.e. size of business, etc).

Under the thin capitalisation rules, the deduction of interest payments will be denied to the extent such interest payments relate to a taxpayer's debt which exceeds the maximum allowable level.

9. Will contractual subordination be honoured by a liquidator or bankruptcy trustee in Japan?

Whether contractual subordination will be honoured by the bankruptcy administrator depends on the nature of the contractual subordination. There are three forms of contractual subordination which may be applicable.

Contractual Subordination under the Bankruptcy Law

Article 99.2 of the Japanese bankruptcy law provides for contractual subordination under an agreement between a creditor and a borrower whereby the claims of such creditor are subordinated to the claims of the general unsecured creditors of the borrower in the event of bankruptcy. This type of contractual subordination will be honoured by the bankruptcy administrator, but is not often seen in acquisition finance transactions, particularly where security is taken by the lenders.

The effect of this type of contractual subordination is that the subordinated creditor's priority of claims will fall between that of the general unsecured creditors and the equity holders.

Contingent Claims

Under this type of contractual subordination, the loan agreement will stipulate that the claims of the mezzanine/junior lender will, upon the insolvency of the borrower, become contingent on the payment in full of the claims of the senior lender. This means that the claims of the mezzanine lender essentially cease to exist until the claims of the senior lender are satisfied. The bankruptcy administrator will, in effect, honour this type of contractual subordination as the claims of the mezzanine lender will not exist at the time of the insolvency. This arrangement is quite common in Japan and effectively secures the priority of the senior lender but it is not popular among mezzanine lenders as it may yield perverse results for the mezzanine lender.

To illustrate, consider a situation where the borrower has assets other than the assets provided as security. To the extent that the value of the assets provided as security equal or exceed the senior claims, then the mezzanine lender's priority will not be adversely affected by this type of contractual subordination (i.e. if the value of the secured assets exceeds the senior claims, then the senior claims will be paid in full, the mezzanine claims will resurface and may be secured by the remaining value of the secured assets if the mezzanine lender has taken security over same. If the value of the secured assets equals the senior claims, then the senior claims will be paid in full, the mezzanine claims will resurface and the mezzanine lender will be in the same position as that of the general unsecured creditors since the secured assets will have been applied to the senior claims). If, however, the secured assets are insufficient to satisfy the senior claims, the mezzanine lender's claims will not resurface until the senior claims are paid in full through the pro rata payment to the senior lender from the pool of unsecured assets. As such, the mezzanine lender will effectively be subordinated to both the senior lender and the general unsecured creditors until the senior claims are paid in full. To mitigate this effect, the mezzanine lender may have a right to repay the remaining amount of the senior claims on behalf of the borrower.

Subordinated Claims

Where the claims of the mezzanine lender remain extant but are contractually subordinated to the senior lender under an intercreditor agreement, the bankruptcy administrator will set aside the contractual subordination and, in the case of secured creditors, distribute the proceeds from the secured assets in accordance with the order of registration or, if registered simultaneously, pro rata between the secured lenders.

While the senior lender may rely on the claw-back provisions of the intercreditor agreement, where the bankruptcy administrator has made payments to the mezzanine lender prior to the satisfaction of the senior claims, the senior lender will then be taking on both the performance risk and credit risk of the mezzanine lender.

Whether Contingent Claims or Subordinated Claims are used generally depends on the relative bargaining power/position of the senior and mezzanine lenders.

Malaysia

1. Is there any prohibition on a company incorporated in Malaysia providing Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

Section 67 of the Malaysian Companies Act 1967 ("**CA**") prohibits the provision of Financial Assistance by a company for the acquisition of shares in that company or its parent company, subject to limited exceptions. Section 67(1) provides that no company shall give, whether directly or indirectly and whether by means of a loan guarantee or the provision of security or otherwise, any Financial Assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or, where the company is a subsidiary, in its holding company, or in any way purchase, deal in or lend money on its own shares.

Nevertheless, there is judicial authority to support the principle that a bona fide transaction entered into in good faith will not be caught by Section 67(1). To determine whether a transaction is bona fide, regard will be made, inter alia, to:

(a) whether the transaction was entered into with the sole or substantial purpose of providing Financial Assistance to allow the acquisition of or subscription for shares in the company or its holding company;

(b) whether the transaction was genuinely entered into for the company's benefit; and

(c) whether the transaction results in a dissipation of the company's financial resources.

Section 67(2) provides for limited exceptions to the general prohibition above. Under Section 67(2), nothing in subsection (1) shall prohibit:

(a) where the lending of money is part of the ordinary business of the company, the lending of money by the company in the ordinary course of its business;

(b) the provision by the company, in accordance with any scheme for the time being in force, of money for the purchase of or subscription for fully paid shares in the company or its holding company, being a purchase or subscription by trustees of or for shares to be held by or for the benefit of employees of the company, or a subsidiary of the company, including any director holding a salaried employment or office in the company or a subsidiary of the company; or

(c) the giving of Financial Assistance by the company to persons, other than directors, bona fide in the employment of the company or a subsidiary of the company, with a view to enabling those persons to purchase fully paid shares in the company or its holding company to be held by themselves by way of beneficial ownership.

Further exceptions include:

(a) a court-ordered compulsory purchase of shares by the company in the event of oppression in disregard of members' interest or unfair discrimination or prejudicial conduct under Section 181 of the CA;

(b) the redemption of preference shares; and

(c) the capitalisation of a share premium account.

A company that fails to comply with Section 67 is not guilty of an offence, though its officers, if found guilty, may be imprisoned for a period of up to five years or fined a sum of up to RM100,000, or both. Further, upon conviction, a court may order the officer to make payment of compensation and the order may be enforced as if it were a judgment.

Significantly, nothing in Section 67 shall operate to prevent a company or person from recovering the amount of any loan made in contravention of this section or any amount for which it becomes liable, either on account of any Financial Assistance given, or under any guarantee entered into or in respect of any security provided in contravention of this section.

Notwithstanding the above, Section 67A of the CA allows a publicly listed company with a share capital to purchase its own shares if authorised by its articles of association.

In order to do so:

(a) the public company must be solvent on the date of the purchase and must not become insolvent by incurring the debts involved in the obligation to pay for the shares so purchased;

(b) the purchase must be made through Bursa Malaysia (the Malaysian stock exchange) on which the shares of the company are quoted and in accordance with the relevant rules of Bursa Malaysia; and

(c) the purchase must be made in good faith and in the interests of the company.

The company shall also, within 14 days after the shares are purchased, lodge with the Companies Commission of Malaysia ("**CCM**") and Bursa Malaysia a notice in the prescribed form.

A company, every officer of the company and any other person in default of Section 67A is guilty of an offence and subject to imprisonment for up to five years or a fine of up to RM100,000, or both.

2. What are the implications under the corporate benefit laws of Malaysia for a company providing Financial Assistance?

In Malaysia, directors of a company possess a fiduciary duty to act in the bona fide interests of the company as a whole and not for any collateral purpose.

What constitutes the 'interests of the company as a whole' will depend on the context in which it is used. It may include the interests of:

(a) the company as a corporate entity;

(b) the company's shareholders;

(c) the company's creditors (where the company is unable to pay its debts); or

(d) the interests of the company as a group.

Where a company is part of a group of companies, the general rule is that the directors of a company are to act in the bona fide interests of that company as opposed to the interests of other companies in the group or the group as a whole. Nevertheless, the courts have held that it is permissible for directors to consider the interests of the group as a whole insofar as these are not detrimental to the company itself or where the interests of the company are inextricably bound to the interests of the other companies in the group or the group as a whole.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarisation, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Shares

In general, security is taken over shares by way of creating a charge over the same in favour of the lender.

If the charge is created by a Malaysian company, the particulars of the charge must be lodged for registration with the CCM (by way of a statutory form known as Form 34) within 30 days of the creation of the charge pursuant to Section 108 of the CA. The lender will usually receive a certificate of registration (commonly referred to as Form 40) within approximately one month from the date of lodgement of Form 34, and brief details of such charge created will be revealed in the official search results issued by the CCM when a company search is conducted with the CCM on the company in question. As provided in Section 108(1) of the CA, if the creation of the charge is not lodged with the CCM within the prescribed time frame and form, the charge shall, insofar as any security on the company's property or undertaking is thereby conferred, be void against the liquidator and any creditor of the company.

In respect of shares listed on Bursa Malaysia, the shares would be scripless and, when charged by the borrower pursuant to appropriate documentation, should be transferred to a pledged securities account opened in favour of the lender as pledgee or alternatively in the name of an authorised nominee. In respect of unlisted shares in a private limited company, the borrower would normally be required to execute and deposit with the lender blank undated transfer forms together with the original share certificates. In addition, depending on circumstances relating to the matter, it is common to procure upfront undated directors' letter of resignation, letter on waiver of pre-emptive rights by other shareholders, special resolution authorising amendments to constitutional documents of the company, and confirmation letter from existing directors that they have no claims against the company should their appointment be terminated.

If the security over the shares is created to secure a foreign credit facility, certain registration requirements may also be imposed by Bank Negara Malaysia ("**BNM**"). This is discussed further under Section 5 below.

On 30 June 2009, the Malaysian Prime Minister announced the liberalisation of a host of restrictions on foreign investments in Malaysia. Malaysia has traditionally imposed restrictions on foreign equity participation across industries and sectors aimed at strengthening Bumiputra participation in the economy. Following the announcement, the approval of the Foreign Investment Committee ("**FIC**") is no longer required where shares in a Malaysian company are charged to a foreign interest.

Assets

The form of security taken over assets will depend on the nature of the assets in question. Assets commonly used as security include real property and movable property.

(a) Real property

Security can be created over land with title or a lease over such land by way of a registered charge pursuant to Section 241(1) of the National Land Code ("NLC"). In accordance with the provisions of Section 242(1) of the NLC, a statutory instrument known as Form 16A must be registered with the relevant land authorities in order for the charge created over the land to be effective as security. Once registered, it will be endorsed as an encumbrance on the title in favour of the lender and the lender will customarily be entitled to custody of the original document of title.

Following the liberalisation of the restrictions on foreign investments, the Malaysian Government has repealed the Guidelines on the Acquisition of Properties by Local and Foreign Interests ("FIC Land Guidelines"). However, restrictions on the FIC Land Guidelines have been re-introduced via the Economic Planning Unit ("EPU") effective 30 June 2009. The approval of EPU will be required under the new Guidelines on the Acquisition of Properties ("EPU Guidelines") only where it involves the dilution of Bumiputra interests (i.e. sale of property by Bumiputra to non-Bumiputra) and/or Government interests properties valued at RM20 million and above, whether bought directly or indirectly through the acquisition of companies owning properties. Save the dilution of interests, all other property transactions (regardless of the nature of the property) shall no longer require the approval of the EPU.

If a Malaysian company is the registered proprietor of the land being charged, then following the execution of the land charge, the particulars of the charge must be lodged with the CCM, and the charge document and corresponding power of attorney (if any) must be stamped at a stamp office in Malaysia. Where the instrument creating the charge contains a power of attorney, such power of attorney needs to be registered at the High Court in Malaya.

In the event that the issue document of title relating to the land has not been issued, security over the land can be created by way of assignment by the borrower of all its rights, title, interests and benefits towards such documentation which evidences the borrower's interest towards the land, coupled with a duly executed power of attorney conferring full power of sale on the lender. This mode of security arrangement is common in instances where land is being sold and the issue document of title relating to such land has not been issued by the relevant authorities. In such instance, an assignment will be created over the sale and purchase agreement.

In the event that such documentation is not available, that is, there is no conveyance involved and no sale and purchase agreement but the issue document of title remains unissued because it is subject to alienation or sub-division exercises, for example, security interest can still be created over the land in the form of a specific debenture. By virtue of the specific debenture, a fixed charge will be created in favour of the chargee and the chargee will be granted the usual remedies of sale, right of possession and right to occupy the said land.

Notwithstanding the above alternative security arrangements, it is to be noted that these alternatives are merely contractual arrangements between the parties and do not create a registered interest over the land, which is indefeasible in nature.

Insofar as registration requirements are concerned, the relevant documents will need to be stamped at a stamp office and the power of attorney contained therein (if any) will need to be registered at the High Court, as discussed above.

(b) Movable property

Security is typically taken over movable property by way of a debenture creating fixed and floating charges over such movable property. A fixed charge will generally be created over all types of classes of assets of the company and a floating charge will generally be created over future assets and those assets which cannot be successfully charged by way of a fixed charge.

The debenture will need to be stamped at a stamp office in Malaysia and, if the debenture contains a power of attorney, it is required to be registered at the High Court.

Tax

Under the First Schedule of the Malaysian Stamp Act 1949 ("SA"), a loan denominated in Ringgit Malaysia will be charged at an ad valorem rate of RM5 for each RM1,000, or a part thereof, whereas the stamp duty payable in respect of a loan denominated in foreign currency will be capped at RM500.

Where the loan agreement has been duly stamped as discussed above, the documents securing the loan can be stamped with a nominal duty of RM10 (Section 4(3) of the SA).

4. How long, following acquisition of a foreign target company, would it usually take in Malaysia for a local subsidiary of such company to grant a guarantee/ security?

Once the local subsidiary has been incorporated, it will be entitled to grant a guarantee/security. There is no requirement regarding any lapse of time following incorporation or completion of an acquisition before a local subsidiary can grant security. Note, however, that under Section 67 of the CA, the local subsidiary will be prohibited from providing a guarantee or security if the underlying loan is entered into for the purposes of acquiring its shares, unless any of the exceptions under the section applies. (Please see discussion under Section 1 above.)

In relation to the timeline to perfect security in Malaysia, the stamping at the stamp office and registration at the High Court, where applicable, should take approximately two working days. On the other hand, BNM approval would take approximately two weeks.

Please note that a financial guarantee is required to be registered seven working days prior to its issuance where the aggregate amount of the financial guarantee issued or obtained by a non-resident exceeds the equivalent of RM50 million. However, this registration requirement will not apply where the financial guarantee is to secure a credit facility which has obtained the prior approval of BNM. (Please see discussion under Section 5 below.)

Conversely, where the approval of BNM is not required for the credit facility, for example, where the Malaysian resident is exempted from having to obtain such approval, any security created by the Malaysian resident in favour of a non-Malaysian resident will be considered as a 'financial guarantee' in favour of a non-resident and, as such, is required to be registered with BNM as discussed above.

5. Are there any restrictions on foreign banks lending to companies in Malaysia? Are interest payments to foreign banks typically subject to withholding tax?

Restrictions on foreign banks lending to companies in Malaysia

A resident company is permitted to obtain foreign currency credit facilities of up to the equivalent of RM100 million in aggregate on a corporate group basis. Foreign currency credit facilities in excess of this amount will require the prior approval of BNM before they can be extended. Among the factors that will be considered in granting approval of the credit facility is whether it will be used for productive purposes in Malaysia. This is a regulatory requirement rather than a restriction against foreign banks lending to Malaysian companies.

However, a Malaysian resident company is free to borrow any amount in foreign currency from:

(a) its non-resident non-bank parent company;[1]

1 A non-resident non-bank parent company refers to:

(a) a non-resident company with more than 50% shareholding in a resident company; or (b) the ultimate non-resident parent company of the resident company, which is not a bank, an investment holding company owned by a bank or a stockbroking company.

(b) other resident companies within the same corporate group in Malaysia; and

(c) licensed onshore banks and licensed International Islamic Banks.

As previously discussed, if any security is granted by a Malaysian company in favour of a non-Malaysian resident to secure a foreign currency credit facility which has obtained the prior approval of BNM, no further registration will be required for the security.

Withholding tax

Section 109 of the Income Tax Act 1967 ("**ITA**") provides that where any person is liable to pay interest derived from Malaysia to a non-resident (other than interest attributable to a business carried on by a non-resident of Malaysia), he/she shall, upon paying or crediting the interest, withhold tax and pay the amount withheld to the Director General of Inland Revenue ("**Director General**") within one month. Currently, the withholding tax rate on interest is 15% of the gross interest (in the absence of a double taxation treaty or unless otherwise varied by the Director General). If the tax is not withheld and paid to the Director General, a claim for its deduction against Malaysia income will be rejected.

Interest derived by a non-resident from the following sources in Malaysia will not be subject to withholding tax:

(a) interest attributable to a business carried on in Malaysia by a non-resident;

(b) interest arising from an approved loan (i.e. loans made to the Government of Malaysia or certain loans made pursuant to an application received prior to 25 October 1996);

(c) interest derived from Malaysia and paid by a banking institution in Malaysia to a non-resident which does not have a permanent establishment there;

(d) interest which is exempt under a double taxation treaty;

(e) interest paid or credited to a non-resident for a year of assessment by Bank Kerjasama Rakyat Malaysia;

(f) interest (or profit or return in the case of Islamic securities) paid or credited to non-resident companies (other than such interest accruing to a place of business in Malaysia of such company) in respect of (i) securities issued by the Government; or (ii) Islamic securities or debentures issued in Ringgit Malaysia (other than convertible loan stock) approved by the Securities Commission ("SC"); or

(g) any profit or return paid or credited to any person in respect of Islamic securities originating from Malaysia (other than convertible loan stock) issued in any currency other than Ringgit Malaysia and approved by the SC; income of a unit trust in respect of interest derived from Malaysia and paid or credited by any bank or financial institution licensed under the Banking and Financial Institutions Act 1989 or the Islamic Banking Act 1983.

6. If a takeover bid which relies on bank debt is made for a publicly listed company in Malaysia, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Takeovers in Malaysia are regulated by the Code on Takeovers and Mergers 1998 ("**Code**") and Division 2 of Part VI of the Capital Markets and Services Act 2007 ("**CMSA**").

Under the Code, a company that intends to make a takeover offer must satisfy certain disclosure obligations before the takeover can be effected. The company must also submit an offer document to the SC for its consent. Once the SC's consent is obtained, the offeror company must post the offer document to the board of directors and shareholders of the offeree company. Where a publicly listed company is the subject of a takeover, the company must make an announcement to Bursa Malaysia Securities Berhad that it has received a notice of an intention to make a takeover in accordance with the Listing Requirements of Bursa Malaysia.

Pursuant to Section 27 of the Code, where the takeover offer is for cash or includes an element of cash, the offeror is required to ensure and the offeror's financial adviser must be reasonably satisfied that the takeover will not fail due to insufficient financial capability of the offeror and that every offeree shareholder that wishes to accept the takeover offer will be paid in full.

Further, Section 13(6) of the Code and Schedules 1(2) and (3) require the offer document to contain a statement to the effect that the offeror and the offeror's financial adviser are satisfied that the above conditions will be met. The provisions also require the offer document to include confirmation by an appropriate third party that there are sufficient resources available to the offeror to enable the offeror to accept and carry out the takeover offer in full. As a matter of practice, the investment bank making the submission to the SC will not proceed with doing so unless it is satisfied that the offeror has adequate financial resources.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Section 291(2) of the CA provides that bankruptcy law applies in respect of the rights of secured creditors in the event that a company undergoes insolvent liquidation. In general, the order of ranking of creditors is as follows:

(a) secured creditors (e.g. persons holding a mortgage, charge or lien over the company's property);

(b) unsecured creditors given priority under Section 292 of the CA; and

(c) other unsecured creditors.

Under Section 292, the order of priority is as follows (note that these cannot be contracted out of):

(a) first, the costs and expenses of the winding up including the taxed costs of a petitioner payable under Section 220, the remuneration of the liquidator and the costs of any audit carried out pursuant to Section 281;

(b) second, all wages or salaries (whether earned wholly or in part by way of commission) including any amount payable by way of allowance or reimbursement under any contract of employment or award or agreement regulating conditions of employment of any employee not exceeding RM1,500, or such other amount as may be prescribed from time to time, whether for time or piecework in respect of services rendered by him/her to the company within a period of four months before the commencement of the winding up;

(c) third, all amounts due in respect of worker's compensation under any written law relating to worker's compensation accrued before the commencement of the winding up;

(d) fourth, all remuneration payable to any employee in respect of vacation leave or, in the case of his/her death, to any other person in his/her right, accrued in respect of any period before the commencement of the winding up;

(e) fifth, all amounts due in respect of contributions payable during the 12 months next before the commencement of the winding up by the company as the employer of any person under any written law relating to employees' superannuation or provident funds or under any scheme of superannuation or retirement benefit which is an approved scheme under the federal law relating to income tax; and

(f) sixth, the amount of all federal tax assessed under any written law before the date of the commencement of the winding up or assessed at any time before the time fixed for the proving of debts expires.

The debts in each class specified above shall rank in the order therein specified. Debts of the same class, however, shall rank equally between themselves, and shall be paid in full unless the property of the company is insufficient to meet them, in which case they shall abate in equal proportions between themselves. Note that insurance debts owed to third parties will take priority over debt holders under Section 292 where the insurance contract is entered into before the commencement of the winding up.

From the above, it is clear that debt holders (e.g. creditors) are given priority over equity holders.

8. Is interest on debt incurred to acquire a company in Malaysia deductible from earnings for tax purposes? Are there any thin capitalisation thresholds?

Interest on debt incurred to acquire a company is deductible from earnings for tax purposes, provided that the debt is incurred for the purpose of generating the company's income and the company intended to utilise the money for such purpose. However, once thin capitalisation rules come into effect, as discussed below, excess interest costs will not be tax-deductible.

With effect from 1 January 2009, thin capitalisation and transfer pricing provisions have been introduced in the ITA. Section 140A(4) ITA provides that where the value of all Financial Assistance to an associated person is excessive in comparison to the fixed capital of the recipient of the Financial Assistance, the interest, finance charge or other consideration payable on the excessive value shall not be deductible.

Note that the effective date for the implementation of the thin capitalisation rules has been deferred from the original effective date of 1 January 2009 until further notice.

9. Will contractual subordination be honoured by a liquidator or bankruptcy trustee in Malaysia?

While a Malaysian court is likely to uphold a contractual arrangement purporting to create an effective subordination of claims, this may not always be the case in the event of the insolvency of the Malaysian company. In particular, it is possible in such an event that a Malaysian court will refuse to give effect to the contractual arrangement if it determines that to do so will be contrary to public policy or will otherwise prejudice or adversely affect the rights of other creditors of the bankrupt Malaysian company.

Philippines

1. Is there any prohibition on a company incorporated in the Philippines providing Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

There is no statutory restriction on providing Financial Assistance[1] in connection with the acquisition of shares in a Philippine corporation or its parent corporation.

A corporation can exercise powers that are (a) expressly allowed under the Corporation Code of the Philippines ("**Corporation Code**"), (b) authorised in the purpose clause of its articles of incorporation ("**AOI**"), and (c) incidental to its existence, or implied or necessary to carry out the purposes as stated in its AOI. Hence, unless the AOI contains an express restriction from doing so, a Philippine corporation may provide Financial Assistance in connection with the acquisition of shares in such corporation or its parent corporation, provided that (a) the extension of such Financial Assistance is reasonably justified to be in furtherance of the Philippine corporation's primary purpose(s), and (b) the applicable approvals are obtained.

Incur, create or increase bonded indebtedness

Under the Corporation Code, no corporation may incur, create or increase any bonded indebtedness unless approved by a majority vote of the board of directors and by the stockholders representing at least two-thirds of

1 'Financial Assistance' means financial assistance in connection with an acquisition given by a company which has been acquired or whose parent company has been acquired by way of:

(a) guarantee or indemnity in respect of the obligations of the acquirer;

(b) grant of security to support the obligations of the acquirer;

(c) loans or transfer of assets to the acquirer; or

(d) dividend or other distribution to the acquirer following the acquisition.

the outstanding capital stock. The Philippine Securities and Exchange Commission ("**SEC**") has ruled that the term 'bonded indebtedness' refers to bonds that are secured by corporate property, as distinguished from 'debentures', which are unsecured corporate indebtedness.

Sell, dispose of, lease or encumber assets

Under the Corporation Code, a corporation, when authorised by a majority vote of the board of directors and by the stockholders representing at least two-thirds of the outstanding capital stock, may sell, lease, exchange, mortgage, pledge or otherwise dispose of all or substantially all its property or assets. The test for determining whether the transaction involves 'substantially all' of the corporate assets or property is whether the sale or disposition of the relevant corporate property or assets will render the corporation incapable of accomplishing its corporate purposes.

Aside from the requirements under the Corporation Code, the mortgage, sale or disposition of all or substantially all of the corporate assets or property may require compliance with the Philippine Bulk Sales law. If the transaction qualifies as a 'sale-in-bulk' under the Bulk Sales law, the seller is required (a) to execute a sworn statement listing its corporate creditors and the amount and nature of their claims, (b) to give notice of the sale, and (c) to apply the proceeds of the sale proportionately to the payment of the listed obligations. Compliance with the Bulk Sales law may be waived in writing by corporate creditors.

Corporate funds in another corporation or business

Under the Corporation Code, a corporation may invest its funds in another corporation or business or for any other purpose other than the primary purpose as stated in its AOI when approved by a majority of the board of directors and ratified by the stockholders representing at least two-thirds of the outstanding capital stock.

Guarantee

In order that a Philippine company may guarantee the performance of the obligations of another firm, entity or person, the AOI of such Philippine corporation should expressly include, as one of its secondary purposes, that it is authorised to guarantee the performance of any undertaking or obligation of other firms, entities or persons.

Third-party mortgage or pledge

The SEC has ruled that the following conditions must be complied with to authorise a corporation to mortgage or pledge corporate assets as security for the obligations of another firm, entity or person:

(a) there is no express restriction in the AOI or By-laws;

(b) the purpose of the mortgage or pledge is not illegal;

(c) written or formal consent of corporate creditors and stockholders must be secured;

(d) the transaction is not used as a scheme to defraud or prejudice creditors or result in the infringement of the trust fund doctrine; and

(e) the mortgage will not hamper the continuous business operations of the mortgagor corporation, and the accommodated third party involved is financially solvent and capable of paying the creditor.

Dividends

Dividends can only be distributed to stockholders. The board of directors of a Philippine stock corporation can declare dividends out of unrestricted retained earnings, which may be payable in cash, property or stock. No stock dividends may be issued without the approval of stockholders representing at least two-thirds of the outstanding capital stock.

2. What are the implications under the corporate benefit laws of the Philippines for a company providing Financial Assistance?

Directors' duty of diligence

The Philippine Supreme Court has held that the primary obligation of the directors of a corporation is "to seek the maximum amount of profits for the corporation", and characterised a director's position as a "position of trust". This fiduciary relationship is not a matter of statutory law, but springs from the fact that directors have control and guidance of corporate affairs and property and hence of the property interest of the stockholders. In line with the directors' fiduciary duty, the Corporation Code provides that directors who wilfully and knowingly vote for or assent to patently unlawful acts of the corporation or who are guilty of gross negligence or bad faith in directing the affairs of the corporation are liable solidarily for all the damages resulting therefrom suffered by the corporation, its stockholders and other persons. At risk of being made personally liable for damages suffered by the corporation, its stockholders and other persons, directors are mandated by this provision to observe a duty of diligence in connection with the corporation providing Financial Assistance.

Corporate rehabilitation scenario

If the Philippine corporation providing the Financial Assistance becomes the subject of corporate rehabilitation, the corporate benefit received by the Philippine corporation in connection with providing the Financial Assistance may have an impact on the rehabilitation court's determination of the terms of repayment or enforcement of obligations incurred by the Philippine corporation in connection with providing the Financial Assistance.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarisation, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

In general, security interest can be taken on all kinds of movable and immovable properties, whether tangible or intangible. In the Philippines, the most widely recognised forms of security arrangements over shares and assets are pledges and mortgages.

Pledge

In order to be valid against third persons, a description of the thing pledged and the date of the pledge must appear in a public instrument. A document is considered a public instrument when it is notarised, or signed and executed before a notary public. The pledge instrument need not be registered. However, if the creditor is given the right to attend and vote at the meetings of stockholders, such right must be in writing and recorded in the corporate books. Delivery of the pledged property into the actual possession of the creditor or other person by common agreement is essential to perfect a pledge.

Mortgage

In creating a mortgage, there is a need to distinguish whether the property subject of the mortgage is immovable or real property, or movable or personal property. If the property is real or immovable, the mortgage should be a real estate mortgage. On the other hand, if the property is movable or personal, then the mortgage should be a chattel mortgage.

A mortgage instrument must be in writing, contain a specific description of the mortgaged property and be executed in the presence of at least two witnesses. In a chattel mortgage, an Affidavit of Good Faith must be executed by the parties, and attached to and registered with the chattel mortgage instrument. The mortgage instrument is required to be in a public instrument in order for it to be recorded in the proper Registry of Deeds.

In order to bind third persons, the mortgage instrument must be registered with the proper Register of Deeds. With regard to real property, the mortgage must be recorded in the Registry of Deeds of the province or city where the property is located. On the other hand, a chattel mortgage must be registered in the Registries of Deeds in (a) the province or city in which the mortgagor resides at the time of execution of the deed of chattel mortgage, and (b) the province or city in which the property is located.

In addition to the registration with the Register of Deeds, a mortgage constituted over motor vehicles, vessels and airplanes must be registered with the Land Transportation Office and Maritime Industry Authority and Air Transportation Office, respectively.

Documentary Stamp Tax

A Documentary Stamp Tax ("**DST**") is imposed on pledges or mortgages based on the secured amount at the following rates:

(a) when the amount secured does not exceed PHP 5,000, a DST of PHP 20; or

(b) on each PHP 5,000, or a fractional part thereof in excess of PHP 5,000, an additional tax of PHP 10.

4. How long, following acquisition of a foreign target company, would it usually take in the Philippines for a local subsidiary of such company to grant a guarantee/security?

There is no statutory waiting periods for a Philippine subsidiary to issue a guarantee or establish a security. Timing will depend on when (a) the approvals for issuance of a guarantee or establishment of a pledge or mortgage are obtained, (b) the DST is paid, in the case of a pledge or mortgage, and (c) the mortgage instrument is registered with the proper Registers of Deeds, in the case of a mortgage.

5. Are there any restrictions on foreign banks lending to companies in the Philippines? Are interest payments to foreign banks typically subject to withholding tax?

A foreign bank lending in the Philippines may be subject to various regulatory and licensing requirements if it is:

(a) doing banking business in the Philippines; or

(b) engaged in the business of a financing corporation in the Philippines.

In the foregoing cases, a foreign bank will have to establish a presence in the Philippines and obtain the relevant permits and licences. Such Philippine entity may also be subject to foreign equity restrictions.

Doing banking business

Under the Philippine General Banking Law, a foreign bank which engages in 'banking business' must obtain (a) a licence to do business from the SEC, and (b) a certificate of authority from the Bangko Sentral ng Pilipinas (the Philippine Central Bank, or "**BSP**"). The BSP issues different types of certificate of authority (e.g. to operate a universal, commercial, thrift, rural or co-operative bank). The requirements for obtaining a certificate of authority will depend on the type of authority being applied for. The activities that may be conducted by the grantee of the certificate of authority will likewise depend on the type of authority issued.

A foreign bank may operate as a bank in the Philippines, subject to prior approval of the Monetary Board of the BSP, by owning up to 60% of the voting stock of an existing domestic bank. At present, the BSP has imposed an indefinite moratorium on the establishment of new banks, except in cities and municipalities where there are no existing banking offices. Thus, a foreign bank cannot invest in the voting stock of a new banking subsidiary. If the moratorium is lifted, a foreign bank may also operate in the Philippines, subject to prior approval by the Monetary Board of the BSP, by investing up to 60% of the voting stock of a new banking subsidiary incorporated under the laws of the Philippines.

A foreign bank may also obtain a certificate of authority to operate an offshore banking unit ("**OBU**") or a representative office ("**Rep Office**"). An OBU does not have full banking authority and refers to a branch, subsidiary or affiliate of a foreign bank which is authorised to engage in banking transactions in foreign currencies involving the receipt of funds principally from external sources and the utilisation of such funds, as allowed by the BSP.

A Rep Office refers to a liaison office of a foreign bank which deals directly with the public by promoting and giving information about the services or products offered by the foreign bank. A Rep Office is not allowed to transact banking business (such as acceptance of deposits, issuance of letters of credit and foreign exchange trading) or otherwise generate income. Transactions generated through the promotional efforts of the Rep Office may be booked only by the foreign bank abroad.

Engaging in a financing company business

A foreign bank which engages in a 'financing company business' as defined under the Financing Company Act of the Philippines ("**FCA**") must establish a Philippine stock corporation which must be at least 40% Filipino-owned, and obtain authorisation from the SEC to operate as a financing company.

A financing company, in the context of the FCA, is an entity primarily engaged in extending credit facilities directly to consumers and to industrial, commercial or agricultural enterprises located in the Philippines on a continuing basis by direct lending, discounting of commercial papers or receivables; by buying and selling contracts, leases, chattel mortgages, or other evidence of indebtedness; or by financial leasing of movable as well as immovable property.

If such entity will engage in quasi-banking functions, it must also obtain the appropriate authorisation from the BSP. Quasi-banking is defined as borrowing funds for the purpose of relending or purchasing receivables from 20 or more lenders at any one time, by issuance, endorsement or acceptance of debt instruments other than deposits.

Interest payments

Interest payments to foreign banks are typically subject to withholding tax.

Under Philippine tax law, non-resident foreign corporations not engaged in trade or business in the Philippines are generally subject to 20% final withholding tax on gross interest received on loans granted to Philippine residents. The 20% final withholding tax rate may be reduced under provisions of Philippine tax treaties with the country where the non-resident foreign corporation is domiciled.

If the foreign bank derives interest income from foreign currency loans granted to Philippine residents (a) through an OBU authorised by the BSP, or (b) under the expanded foreign currency deposit system ("**EFCDU**"), the interest income will be subject to 10% final withholding tax. In the foregoing context, the term 'Philippine residents' excludes other offshore banking units, local commercial banks (including local branches of foreign banks that may be authorised by the BSP to transact with OBUs), and other depository banks under the EFCDU system.

6. If a takeover bid which relies on bank debt is made for a publicly listed company in the Philippines, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Under the Philippines Securities Regulation Code ("**SRC**"), a tender offer[2] is defined as an offer by an acquiring person to the stockholders of a

2 A tender offer is a publicly announced intention by a person, acting alone or in concert with other persons, to acquire equity securities of a public company.

public corporation[3] for them to tender their shares on the terms specified in the offer. Such share acquisition will be subject to the rules on 'mandatory tender offer' under the SRC if the number of shares intended to be acquired will reach the trigger threshold of generally 35% or more of a class of equity securities or shares of stock.

Rule 19 of the implementing rules of the SRC requires any person making a tender offer to make an announcement of his/her intention in a newspaper of general circulation prior to the commencement of the offer. Such announcement must not be made until the bidder has the resources to implement the offer in full. The SEC also requires the filing by the bidder of, among others, confirmation by the bidder's financial adviser or another appropriate third party that resources available to the bidder are sufficient to satisfy full acceptance of the offer.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Order of priority

Under the Financial Rehabilitation and Insolvency Act of 2010 ("**FRIA**"), the obligations of an insolvent debtor will be paid following the order of priority established in the Civil Code of the Philippines ("**Civil Code**") and other relevant laws pertaining to the concurrence and preference of credits, unless a preferred creditor voluntarily waives his preferred right. The following sets forth the order of priority:

3 A public company is defined as a corporation (a) which is listed on the Philippine Stock Exchange ("**PSE**"), or (b) with assets exceeding PHP 50,000,000 and with 200 or more stockholders, at least 200 of whom hold not less than 100 shares of such company.

(a) Special preferred credits with respect to specific movable property under Article 2241[4] of the Civil Code and special preferred credits with respect to specific real property under Article 2242[5] of the

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4 Article 2241 of the Civil Code provides that, with reference to specific movable property of the debtor, the following claims or liens shall be preferred:

(a) Duties, taxes and fees due thereon to the State or any subdivision thereof;

(b) Claims arising from misappropriation, breach of trust, or malfeasance by public officials committed in the performance of their duties, on the movables, money or securities obtained by them;

(c) Claims for the unpaid price of movables sold, on said movables, so long as they are in the possession of the debtor, up to the value of the same; and if the movable has been resold by the debtor and the price is still unpaid, the lien may be enforced on the price; this right is not lost by the immobilisation of the thing by destination, provided that it has not lost its form, substance and identity; neither is the right lost by the sale of the thing together with other property for a lump sum when the price thereof can be determined proportionally;

(d) Credits guaranteed with a pledge so long as the things pledged are in the hands of the creditor, or those guaranteed by a chattel mortgage, upon the things pledged or mortgaged, up to the value thereof;

(e) Credits for the making, repair, safekeeping or preservation of personal property, on the movable thus made, repaired, kept or possessed;

(f) Claims for labourers' wages, on the goods manufactured or the work done;

(g) For expenses of salvage, upon the goods salvaged;

(h) Credits between the landlord and the tenant arising from the contract of tenancy on shares, on the share of each in the fruits or harvest;

(i) Credits for transportation, upon the goods carried, for the price of the contract and incidental expenses, until their delivery and for 30 days thereafter;

(j) Credits for lodging and supplies usually furnished to travelers by hotel keepers, on the movables belonging to the guest as long as such movables are in the hotel, but not for money loaned to the guests;

(k) Credits for seeds and expenses for cultivation and harvest advanced to the debtor, upon the fruits harvested;

(l) Credits for rent for one year, upon the personal property of the lessee existing on the immovable leased and on the fruits of the same, but not on money or instruments of credit; and

(m) Claims in favour of the depositor if the depositary has wrongfully sold the thing deposited, upon the price of the sale.

In the foregoing cases, if the movables to which the lien or preference attaches have been wrongfully taken, the creditor may demand them from any possessor, within 30 days from the unlawful seizure.

5 Article 2242 of the Civil Code provides that, with reference to specific immovable property and real rights of the debtor, the following claims, mortgages and liens shall be preferred, and shall constitute an encumbrance on the immovable or real right:

(a) Taxes due upon the land or building;

(b) For the unpaid price of real property sold, upon the immovable sold;

Civil Code.

There is a first-tier preference that includes only taxes, duties and fees due on specific movable or immovable property. All other special preferred but non-tax credits (e.g. credit secured by mortgages) stand on the second tier to be satisfied *pari passu* out of any residual value of the specific property to which such other credits relate. This rule, however, does not apply to credits registered with the Register of Deeds, by virtue of a judicial order, by attachment or execution. In satisfying these credits, the rule is priority of the credits in the order of time.

(b) Ordinary preferred credits listed under Article 2244[6] of the Civil Code Credits that do not enjoy any preference with respect to specific

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(c) Claims of labourers, masons, mechanics and other workmen, as well as of architects, engineers and contractors, engaged in the construction, reconstruction or repair of buildings, canals or other works, upon said buildings, canals or other works;

(d) Claims of furnishers of materials used in the construction, reconstruction, or repair of buildings, canals or other works, upon said buildings, canals or other works;

(e) Mortgage credits recorded in the Registry of Property, upon the real estate mortgaged;

(f) Expenses for the preservation or improvements of real property when the law authorises reimbursement, upon the immovable preserved or improved;

(g) Credits annotated in the Registry of Property, by virtue of a judicial order, by attachment or execution, upon the property affected, and only as to later credits;

(h) Claims of co-heirs for warranty in the partition of an immovable among them, upon the real property thus divided;

(i) Claims of donors of real property for pecuniary charges or other conditions imposed upon the donee, upon the immovable donated; and

(j) Credits of insurers, upon the property insured, for the insurance premium for two years.

6 Article 2244 of the Civil Code provides that with reference to other property of the debtor to which no specific liens attach, the Civil Code states that the following claims or credits shall be preferred in the order named:

(a) Proper funeral expenses for the debtor or children under his/her parental authority who have no property of their own, when approved by the court;

(b) Credits for services rendered the insolvent by employees, labourers, or household helpers for one year preceding the commencement of the insolvency proceedings;

(c) Expenses during the last illness of the debtor or his/her spouse and children under his/her parental authority, if they have no property of their own;

(d) Compensation due the labourers or their dependents under the laws providing for indemnity for damages in case of labour accident or illness resulting from the nature of employment;

(e) Credits and advancements made to the debtor for support of himself/herself and property because they are not among those listed under Articles 2241 and 2242 and those that, while included in said articles, are unpaid because the value of the property to which the preference refers is less than the preferred credit(s), will be satisfied in the order established in Article 2244. For purposes of implementing the liquidation plan under the FRIA, credits for services rendered by employees or labourers to the debtor shall enjoy first preference under Article 2244 of the Civil Code, unless the claims constitute legal liens under Article 2241 and 2242 thereof. Unlike Articles 2241 and 2242, Article 2244 creates no liens on determinate property of the debtor. Article 2244 creates preference in favour of certain creditors to have the assets of the insolvent debtor applied in a certain sequence or order of priority.

(c) Ordinary claims, which are claims that are not included in Order of Priority (a) or (b) above, and have been duly proved and approved in the liquidation proceedings

Ordinary claims will share pro rata in the remainder of the debtor's property, without any priority or preference.

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his/her family during the last year preceding the insolvency;

(f) Support during the insolvency proceedings, and for three months thereafter;

(g) Fines and civil indemnification arising from a criminal offence;

(h) Legal expenses and expenses incurred in the administration of the insolvent's estate for the common interest of the creditors, when properly authorised and approved by the court;

(i) Taxes and assessments due the national government other than those taxes and assessments on specific property of the debtor which form a lien on such property;

(j) Taxes and assessments due any province other than those taxes and assessments on specific property of the debtor which form a lien on such property;

(k) Taxes and assessments due any city or municipality other than those taxes and assessments on specific property of the debtor which form a lien on such property;

(l) Damages for death or personal injuries caused by a quasi-delict;

(m) Gifts due to public and private institutions of charity or beneficence; and

(n) Credits which, without special privilege, appear in (a) a public instrument; or (b) in a final judgment, if they have been the subject of litigation. These credits shall have preference among themselves in the order of priority of the dates of the instrument and of the judgments, respectively.

Trust fund doctrine

Philippine law adheres to the trust fund doctrine, which provides that the capital stock of the corporation, as well as its property and assets are generally regarded in equity as a trust fund for the payment of corporate debts and the creditors have the right to priority payment over any stockholders of the corporation.

Consistent with the trust fund doctrine, debt holders are given preference over equity holders. Upon liquidation of the corporation, only the balance after paying the claims of corporate creditors is to be distributed to the stockholders.

8. Is interest on debt incurred to acquire a company in the Philippines deductible from earnings for tax purposes? Are there any thin capitalisation thresholds?

Interest on debt incurred is generally deductible from earnings for income tax purposes.

There are no statutory thin capitalisation thresholds that are imposed generally. However, certain debt-to-equity ratios are required in connection with registering with certain government agencies, such as the SEC with respect to an application for registration of a Philippine branch and the Board of Investments ("**BOI**"), or qualifying as proponents of certain government projects.

9. Will contractual subordination be honoured by a liquidator or bankruptcy trustee in the Philippines?

Financial Rehabilitation and Insolvency Act

The FRIA prescribes the order of priority in which the obligations of the debtor must be paid (after the debtor's assets are liquidated), as follows:

(a) special preferred credits under Articles 2241 and 2242 of the Civil Code;

(b) ordinary preferred credits under Article 2244 of the Civil Code, provided that for purposes of implementing the liquidation plan under the FRIA, credits for services rendered by employees or labourers to the debtor shall enjoy first preference; and

(c) ordinary claims, which are claims approved and allowed in the liquidation proceedings and not falling in (a) or (b) above.

Based on the foregoing, a Philippine court exercising jurisdiction over liquidation proceedings may refuse to recognise a contractual subordination that is not consistent with the order of priority prescribed under the Insolvency Law.

Corporate rehabilitation

The provisions on corporate rehabilitation under the FRIA provide that contracts and other arrangements between the debtor and its creditors will be interpreted as continuing to apply to the extent that these contracts and other arrangements are not in conflict with the approved rehabilitation plan. The approved rehabilitation plan is binding upon all persons who may be affected by it, including creditors who may not have participated in the proceedings or those who oppose the approved rehabilitation plan. Thus, any subordination agreement may be rendered ineffective, if (a) such priority/ subordination agreement is not recognised in the rehabilitation plan or (b) even if it is so recognised (e.g. over the objection of the 'subordinated lenders'), the rehabilitation court subsequently determines that maintaining such a preference will ultimately prevent or hinder the rehabilitation of the corporation.

Singapore

1. Is there any prohibition on a company incorporated in Singapore providing Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

Section 76(1) of the Companies Act, Chapter 50 of Singapore (the "**Companies Act**") prohibits a company from giving any Financial Assistance for the purpose of, or in connection with, the acquisition by any person of shares in that company or shares in the holding company of that company ("**unlawful financial assistance**").
Section 76(1) (a) states that:

"Except as otherwise expressly provided by this Act, a company shall not, whether directly or indirectly, give any Financial Assistance for the purpose of, or in connection with:

(a) the acquisition by any person, whether before or at the same time as the giving of the financial assistance, of (A) shares or units of shares in the company; or (B) shares or units of shares in a holding company of the company; or

(b) the proposed acquisition by any person of (A) shares or units of shares in the company; or (B) shares or units of shares in a holding company of the company".

The giving of unlawful Financial Assistance includes Financial Assistance by means of the making of a loan, the giving of a guarantee, the provision of security, the release of an obligation or the release of a debt or otherwise.

Section 76(3) goes on to provide that a company shall be taken to have given Financial Assistance for the purpose of an acquisition or proposed acquisition referred to in Section 76(1)(a) (referred to as the "**relevant purpose**") if:

(a) the company gave the Financial Assistance for purposes that included the relevant purpose; and

(b) the relevant purpose was a substantial purpose of the giving of the Financial Assistance.

The Singapore courts will examine the relevant arrangements to determine if there is any unlawful Financial Assistance or if the relevant arrangements are camouflaging any unlawful Financial Assistance. One of the key questions the courts may ask is whether parties would have entered into the acquisition for the shares but for the arrangement in question.

Sections 76(9A), 76(9B) and 76(10) set out the various different whitewash procedures that may be followed to enable a company to provide Financial Assistance for the acquisition of its shares or shares in its holding company, assuming that there are no other relevant exemptions. Sections 76(8) and (9) contain a list of items that are expressly carved out from the Financial Assistance prohibition. The whitewash procedures are set out in Appendix A.

A contract or transaction made in contravention of Section 76(1)(a) shall be void if it falls within the type of contract or transaction listed in Section 76A(1). All other contracts or transactions in contravention of Section 76(1)(a) shall be voidable at the option of the company. A "related" contract or transaction is also voidable. Section 76A(14) defines what "related" means in this context. Where a company gives Financial Assistance, any contract or transaction engaged in as a result of or by means of or in relation to the Financial Assistance is deemed to be a related transaction. In addition, if there is a breach of Section 76(1), each officer of the company in default shall be guilty of an offence and liable on conviction to a fine not exceeding SGD20,000 and/or to imprisonment for a term not exceeding three years.

Before a company can avoid such a contract or transaction, notice in writing must be given to the other parties to the contract or transaction. This notice may be given by the company itself or, if the court so authorises, by a member of the company, a trustee for the debenture holders, a debenture holder or a director. However, a contract or a transaction is not voidable if it is entered into in reliance on a certificate stating that the requirements of 76(9A), 76(9B) or 76(10) (as the case may be) have been complied with. The certificate must have been signed by two directors or a director and a secretary. This does not apply if the person relying on the certificate became aware before the contract was made or the transaction was engaged in that the requirements of 76(9A), 76(9B) or 76(10) (as the case may be) had not been complied with.

2. What are the implications under the corporate benefit laws of Singapore for a company providing Financial Assistance?

In Singapore, directors of a company must act in the interests of the company. Section 157 of the Companies Act provides that a director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his/her office. The phrase “act honestly” has been interpreted to mean “acting bona fide in the interests of the company in the performance of the functions attaching to the office of director”. Directors in Singapore also owe fiduciary duties, as a matter of common law, to the company to act in the interest of the company.

When considering the provision of Financial Assistance for the acquisition of the company’s shares, directors must continue to act in the interest of the company. It should also be noted that corporate benefit should accrue to the company and not just to another company in the group. What amounts to commercial benefit depends on the facts of each case and this is ultimately a question for the court to decide (if the matter is brought to court).

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarisation, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The most typical types of security granted over property in Singapore include:

(a) for scrip shares, share mortgages which may be legal or equitable;

(b) for scripless shares, a statutory assignment or charge in a prescribed form under Section 130N of the Companies Act or a common law charge/assignment;

(c) for other assets, fixed and floating charges in the form of debentures; and

(d) for land, real property mortgages which may be statutory or equitable.

Scrip shares

The main difference between an equitable mortgage of shares and a legal mortgage of shares is that with an equitable mortgage, the mortgagee will have possession of the share certificates in respect of those shares mortgaged to it without having the shares registered in its name (or in the name of its nominee), whereas with a legal mortgage, the shares are actually transferred to the mortgagee or its nominee and registered in the name of the mortgagee or its nominee (as the case may be).

Scripless shares – statutory assignment/charge

In order to create a statutory assignment or a statutory charge, both the chargor and the chargee will be required to have a direct account with the Central Depository (Pte) Limited ("CDP") which operates the Central Depository System for the holding and transfer of book-entry securities.

In the case of an assignment, CDP will forthwith, upon receipt of the instrument of assignment (which is in a prescribed form), by way of an off-market transaction (i.e. a transaction effected outside the Securities Exchange), transfer the book-entry securities to the assignee. In the case of a charge, CDP will forthwith, upon receipt of the instrument of charge (which is in a prescribed form), register the instrument in a register of charges maintained by CDP.

Subsequent to the assignment or charge, the assignor and the chargor cannot create any further security interest in any of the book-entry securities in favour of any other person. Any such assignment or charge will be void. However, the assignee or the chargee may sub-charge the book-entry securities.

Scripless shares – common law charge

Regulation 23A of the Companies (Central Depository System) Regulations allows for the creation of a common law charge (i.e. not registrable with the CDP) between sub-account holders of the same depository agent. The Regulation states that "*nothing in Section 130N of the Companies Act shall be construed as precluding a sub-account holder from creating under any rule of law any security interest in book-entry securities in favour of any other sub-account holder who maintains a sub-account for such book-entry securities with the same depository agent as the sub-account holder*". Therefore, provided both chargor and chargee have sub-accounts with the same depository agents, the chargor can create a common law assignment or charge in favour of the chargee instead of the statutory assignment or charge prescribed by Section 130N of the Companies Act.

Registration

A charge to which Section 131 of the Companies Act applies where created by a company incorporated pursuant to the Companies Act shall be lodged with the Accounting and Corporate Authority of Singapore ("**ACRA**") for registration within 30 days after its creation, failing which the charge shall, so far as any security on the company's property or undertaking is thereby conferred, be void against the liquidator and any creditor of the company.

Charges to which Section 131 of the Companies Act applies are:

(a) a charge to secure any issue of debentures;

(b) a charge on uncalled share capital of a company;

(c) a charge on shares of a subsidiary of a company which are owned by the company;

(d) a charge or an assignment created or evidenced by an instrument which if executed by an individual, would require registration as a bill of sale;

(e) a charge on land wherever situated or any interest therein;

(f) a charge on book debts of the company;

(g) a floating charge on the undertaking or property of a company;

(h) a charge on calls made but not paid;

(i) a charge on a ship or aircraft or any share in a ship or aircraft; and

(j) a charge on goodwill, on a patent or licence under a patent, on a trademark, or on a copyright or a licence under a copyright.

Apart from registration under the Companies Act, there may be additional registration requirements depending on the nature of the charged asset. For example, a charge or mortgage over a ship must be registered with the Registry of Ships.

Stamp duty

Where the mortgage involves shares or land, stamp duty up to a maximum of SGD500 would be payable where such mortgage is executed in Singapore, or if executed outside of Singapore, it is received in Singapore. For a legal mortgage of shares or land, stamp duty is calculated at SGD4 for every SGD1,000 or any part thereof being a security (other than an equitable mortgage) for the payment or repayment of money, subject to a maximum of SGD500. For an equitable mortgage of shares or land, stamp duty is calculated at SGD2 for every SGD1,000 or any part thereof being a security for the payment or repayment of money, subject to a maximum of SGD500.

4. How long, following acquisition of a foreign target company, would it usually take in Singapore for a local subsidiary of such company to grant a guarantee/security?

In Singapore, if the whitewash procedure is completed before the acquisition of the foreign target company takes place, then the guarantee/security may be granted by the local subsidiary at the same time as the acquisition.

The procedure under Section 76(10) will require no less than 35 days to be completed. In practice, a longer period may be needed to coordinate and ensure that all documents are in order and the necessary filings are done. In this regard, we have assumed that the directors are cooperative and are available to sign and/or pass the relevant resolutions and statements.

As for the procedure under Section 76(9B), the process should take less than two weeks to complete and in the case of Section 76(9A), an even shorter period (since no shareholders' resolutions are required to be passed). However, the procedure under Section 76(9A) can be used only if the value of the guarantee/security does not exceed 10% of the aggregate total paid-up capital and reserves of the local subsidiary granting the guarantee/security.

If the directors are uncomfortable about providing solvency statements, which are a mandatory feature of the steps under Sections 76(9A) and (9B), then the longer process under Section 76(10) has to be undertaken. Nowadays, most companies would usually adopt the procedure under Section 76(9A) or 76(9B) (depending on whether the amount of Financial Assistance exceeds 10% of the aggregate total paid-up capital and reserves of the company) as the process is shorter and simpler.

5. Are there any restrictions on foreign banks lending to companies in Singapore? Are interest payments to foreign banks typically subject to withholding tax?

Where there is "system and continuity" in a person's lending activities in Singapore or where a person is ready and willing to lend to "all and sundry", such a person is required by the Moneylenders Act, Chapter 188 of Singapore to establish a presence in Singapore and obtain a moneylender's licence from the Registry of Moneylenders. One local case has clarified what "system and continuity" means:

"All the authorities indicate that there must be more than occasional loans. This is what is meant by continuity. The loans must be part of an ongoing and routine series of transactions made by the alleged moneylender. The requirement of system on the other hand has not been explicitly clarified. But it is evident that the need for system shows that there must be an organised scheme of moneylending. Some indicators of such a scheme would be fixed rates, the rate of interest being dependent on the creditworthiness and past conduct of the borrower and a clear and definite repayment plan. Such factors distinguish organised moneylending from occasional loans, which would be outside the mischief of the Act".

However, where the entity involved is a foreign bank, it is usually more appropriate for the foreign bank to obtain a banking licence from the Monetary Authority of Singapore ("**MAS**") since a banking licence would allow it to expand its activities beyond lending. A foreign bank which has a licence from the MAS will not be classified as a moneylender under the Moneylenders Act.

Section 4 of the Banking Act, Chapter 19 of Singapore provides that no banking business shall be transacted in Singapore except by a company which is in possession of a valid licence granted under the Banking Act. "Banking business" is defined in the Banking Act as the business of receiving money on current or deposit account, paying and collecting cheques drawn by or paid in by customers, the making of advances to customers and includes such other business as the MAS may prescribe for the purposes of the Banking Act.

However, lending to a Singapore company on a one-off or very limited basis will in most cases probably not qualify as carrying on "banking business" nor would it be considered moneylending that is prohibited under the Moneylenders Act.

Interest payments out of Singapore to a Singapore non-resident person are generally subject to withholding tax under the Income Tax Act, Chapter 134 of Singapore. Where the non-resident does not derive the interest income from operations carried out in Singapore, the withholding tax rate is 15%. Where the non-resident derives the interest income from operations carried out in Singapore, the withholding tax rate is the prevailing income tax rate in Singapore. Rates of withholding tax with respect to interest may be reduced under Singapore's various double tax treaties.

6. If a takeover bid which relies on bank debt is made for a publicly listed company in Singapore, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Under the Singapore Code on Take-overs and Mergers (the "**Take-over Code**"), rule 3.5, where the offer is for cash or involves an element of cash, the announcement of an offer should include an unconditional confirmation by a financial adviser or by an appropriate third party that the offeror has sufficient resources available to satisfy full acceptance of the offer.

Under the notes on rule 3.5, the Securities Industry Council of Singapore may require evidence to support a statement that resources are available to satisfy the offeror's obligations. The Securities Industry Council of Singapore may also require evidence that the offeror has sufficient resources to complete the purchase of shares which gives rise to the obligations.

Under rule 23.8 of the Take-over Code, where the offer is for cash or includes an element of cash, the offer document must also include an unconditional confirmation by an appropriate third party (for example, the offeror's banker or financial adviser) that resources are available to the offeror sufficient to satisfy full acceptance of the offer. However, the party confirming that resources are available will not be expected to produce the cash if, in giving the confirmation, it acted responsibly and took all reasonable steps to assure itself that the cash would be available to satisfy full acceptance of the offer. The Securities Industry Council of Singapore reserves the right to require evidence to support such confirmation.

Generally, under rule 4 of the Take-over Code, where the offeror has announced a firm intention to make an offer, it cannot withdraw the offer without the Securities Industry Council of Singapore's consent unless the offer has been subject to the prior fulfilment of a specific condition and that condition has not been met.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

In general, the order of ranking of creditors in descending order of priority when the company is wound up would be:

(a) Secured creditors except holders of debentures under any floating charge

(b) Preferred creditors who are entitled to be paid, *pari passu*, as set out in Section 328(1) of the Companies Act:

   (i) first, cost and expenses of the winding up (including taxed costs of the applicant for winding up order, remuneration of the liquidator and the costs of any audit);

(ii) second, all wages or salary including any amount payable by way of allowance or reimbursement under any contract of employment or award or agreement regulating conditions of employment of any employee subject to a limit;

(iii) third, the amount due to an employee as a retrenchment benefit or ex gratia payment under any contract of employment or award or agreement that regulates conditions of employment subject to a limit;

(iv) fourth, all amounts due in respect of work injury compensation under the Work Injury Compensation Act. Chapter 354 of Singapore, accrued before, on or after the commencement of the winding up;

(v) fifth, all amounts due in respect of contributions payable during the 12 months before, on or after the commencement of winding up by the company as the employer of any person under any written law relating to employees' superannuation or provident funds or under any scheme of superannuation which is an approved scheme under the law relating to income tax; and

(vi) sixth, all remuneration payable to any employee in respect of vacation leave, or, in the case of his death, to any other person in his right, accrued in respect of any period before, on or after the commencement of the winding up;

(vii) seventh, the amount of all tax assessed and all goods and services tax due under any written law before the commencement of the winding up or assessed at any time before the time fixed for the proving of debts has expired.

(Note: The amount payable under paragraphs (ii) and (iii) above shall not exceed an amount that is equivalent to five months' salary whether for time or piecework in respect of services rendered by the employee to the company or SGD7,500, whichever is the lesser. Pursuant to Section 328(5) of the Companies Act, creditors under paragraphs (iv) and (vii) above do not rank ahead of holders of debentures under any floating charge in priority.)

(c) Holders of debentures under any floating charge

(d) Ordinary unsecured creditors, *pari passu*

(e) Shareholders

As can be seen above, debt holders are generally given priority over equity holders by law. It should also be noted that if a charge (which is required to be registered – see answers to question 3 above) is not registered within 30 days of its creation, it becomes void against the liquidator and any creditor of the company. In other words, for practical purposes, the chargee is unsecured if the company goes into liquidation.

The order of priority of charges may also be affected by any inter-creditor agreements or similar agreements and arrangements between the secured creditors.

8. Is interest on debt incurred to acquire a company in Singapore deductible from earnings for tax purposes? Are there any thin capitalisation thresholds?

If the debt is incurred, the interest payments on the debt will only be deductible against taxable income generated from such an acquisition. In case the debt is incurred to acquire the shares of a company and the income from the shares is in the form of dividends, such dividends may be exempt from tax, in which case the interest expense will not be deductible.

There are no thin capitalisation rules in Singapore.

9. Will contractual subordination be honoured by a liquidator or bankruptcy trustee in Singapore?

There is no legislation on the validity of contractual subordination in the event of the insolvency of the debtor company unlike in Australia where Section 563C was introduced into the Australian Corporations Act. As such, case law would have to be resorted to.

In the 2006 English case of *In re SSSL Realisations* (2002) Ltd (in liquidation) and another company [2006] EWCA Civ 7, the English Court of Appeal gave weight to the commercial expectation of the parties and held that "if group companies enter into subordination agreements of this nature with their creditors while solvent, they and their creditors should be held to the bargain when the event for which the agreement was intended to provide (insolvency) occurs". The court held that a subordination agreement is valid and binding. It is likely that the same position will be taken in Singapore.

Appendix

Section 76(9A)

Nothing in Section 76(1) prohibits the giving by a company of Financial Assistance for the purpose of, or in connection with, an acquisition or proposed acquisition by a person of shares or units of shares in the company or in a holding company of the company if:

(a) the amount of the Financial Assistance, together with any other Financial Assistance given by the company under this subsection repayment of which remains outstanding, would not exceed 10% of the aggregate of :

(i) the total paid-up capital of the company; and

(ii) the reserves of the company,

as disclosed in the most recent financial statements of the company;

(b) the company receives fair value in connection with the Financial Assistance;

(c) the board of directors of the company passes a resolution that:

(i) the company should give the assistance;

(ii) giving the assistance is in the best interests of the company; and

(iii) the terms and conditions under which the assistance is given are fair and reasonable to the company;

(d) the resolution sets out in full the grounds for the directors' conclusions;

(e) all the directors of the company make a solvency statement in relation to the giving of the Financial Assistance;

(f) within 10 business days of providing the Financial Assistance, the company sends to each member a notice containing particulars of:

(i) the class and number of shares or units of shares in respect of which the Financial Assistance was or is to be given;

(ii) the consideration paid or payable for those shares or units of shares;

(iii) the identity of the person receiving the Financial Assistance and, if that person is not the beneficial owner of those shares or units of shares, the identity of the beneficial owner; and

(iv) the nature and, if quantifiable, the amount of the Financial Assistance.

(g) not later than the business day next following the day when the notice referred to in paragraph (f) is sent to members of the company, the company lodges with the Registrar of Companies a copy of that notice and a copy of the solvency statement referred to in paragraph (e).

Section 76(9B)

Nothing in Section 76(1) prohibits the giving by a company of Financial Assistance for the purpose of, or in connection with, an acquisition or proposed acquisition by a person of shares or units of shares in the company or in a holding company of the company if:

(a) the board of directors of the company passes a resolution that:

  (i) the company should give the assistance;

  (ii) giving the assistance is in the best interest of the company; and

  (iii) the terms and conditions under which the assistance is given are fair and reasonable to the company;

(b) the resolution sets out in full the grounds for the directors' conclusions;

(c) all the directors of the company make a solvency statement in relation to the giving of the Financial Assistance;

(d) not later than the business day next following the day when the resolution referred to in paragraph (a) is passed, the company sends to each member having the right to vote on the resolution referred to in paragraph (e) a notice containing particulars of:

  (i) the directors' resolution referred to in paragraph (a);

  (ii) the class and number of shares or units of shares in respect of which the Financial Assistance is to be given;

  (iii) the consideration payable for those shares or units of shares;

  (iv) the identity of the person receiving the Financial Assistance and, if that person is not the beneficial owner of those shares or units of shares, the identity of the beneficial owner;

  (v) the nature and, if quantifiable, the amount of the Financial Assistance; and

(vi) such further information and explanation as may be necessary to enable a reasonable member to understand the nature and implications for the company and its members of the proposed transaction;

(e) a resolution is passed:

(i) by all the members of the company present and voting either in person or by proxy at the relevant meeting; or

(ii) if the resolution is proposed to be passed by written means, by all the members of the company,

to give that assistance;

(f) not later than the business day following the day the resolution referred to in paragraph (e) is passed, the company lodges with the Registrar of Companies a copy of that resolution and a copy of the solvency statement referred to in paragraph (c); and

(g) the Financial Assistance is given not more than 12 months after the resolution referred to in paragraph (e) is passed.

Section 76(10)

(10) Nothing in Section 76(1) prohibits the giving by a company of Financial Assistance for the purpose of, or in connection with, an acquisition or proposed acquisition by a person of shares or units of shares in the company or in a holding company of the company if:

(a) the company, by special resolution, resolves to give Financial Assistance for the purpose of or in connection with, that acquisition;

(b) where:

(i) the company is a subsidiary of a listed corporation; or

(ii) the company is not a subsidiary of a listed corporation but is a subsidiary whose ultimate holding company is incorporated in Singapore, the listed corporation or the ultimate holding company, as the case may be, has, by special resolution, approved the giving of the Financial Assistance;

(c) the notice specifying the intention to propose the resolution referred to in paragraph (a) as a special resolution sets out:

  (i) particulars of the Financial Assistance proposed to be given and the reasons for the proposal to give that assistance; and

  (ii) the effect that the giving of the Financial Assistance would have on the financial position of the company and, where the company is included in a group of corporations consisting of a holding company and a subsidiary or subsidiaries, the effect that the giving of the Financial Assistance would have on the financial position of the group of corporations,

  and is accompanied by a copy of a statement made in accordance with a resolution of the directors, setting out the names of any directors who voted against the resolution and the reasons why they so voted, and signed by not less than two directors, stating whether, in the opinion of the directors who voted in favour of the resolution, after taking into account the financial position of the company (including future liabilities and contingent liabilities of the company), the giving of the Financial Assistance would likely prejudice materially the interest of the creditors or members of the company or any class of those creditors or members;

(d) the notice specifying the intention to propose the resolution referred to in paragraph (b) as a special resolution is accompanied by a copy of the notice, and a copy of the statement referred to in paragraph (c);

(e) not later than the day following the day the notice referred to in paragraph (c) is despatched to members of the company and there is lodged with the Registrar of Companies a copy of that notice and a copy of the statement that accompanied that notice;

(f) the notice referred to in paragraph (c) and a copy of the statement referred to in that paragraph are sent to:

(i) all members of the company;

(ii) all trustees for debenture holders of the company; and

(iii) if there are no trustees for, or for a particular class of, debenture holders of the company — all debenture holders, or all debenture holders of that class, as the case may be, of the company whose names are, at the time the notice is despatched, known to the company;

(g) the notice referred to in paragraph (d) and the accompanying documents are sent to:

(i) all members of the listed corporation or of the ultimate holding company;

(ii) all trustees for debenture holders of the listed corporation or of the ultimate holding company; and

(iii) if there are no trustees for, or for a particular class of, debenture holders of the listed corporation or of the ultimate holding company — all debenture holders or debenture holders of that class, as the case may be, of the listed corporation or of the ultimate holding company whose names are, at the time the notice is despatched, known to the listed corporation or the ultimate holding company;

(h) within 21 days after the date on which the resolution referred to in paragraph (a) is passed or, in a case to which paragraph (b) applies, the date on which the resolution referred to in that paragraph is passed, whichever is later, a notice:

(i) setting out the terms of the resolution referred to in paragraph (a); and

(ii) stating that any of the persons referred to in subsection (12) may, within the period referred to in that subsection, make an application to the Court opposing the giving of the Financial Assistance,

is published in a daily newspaper circulating generally in Singapore;

(i) no application opposing the giving of the Financial Assistance is made within the period of 21 days after the publication of the notice referred to in (h) above or, if such an application or applications has or have been made, the application or each of the applications has been withdrawn or the Court has approved the giving of the Financial Assistance; and

(j) the Financial Assistance is given in accordance with the terms of the resolution referred to in paragraph (a) and not earlier than:

(i) in a case to which sub-paragraph (ii) does not apply, the expiration of the period referred to in subsection (12); or

(ii) if an application or applications has or have been filed with the Court within that period:

a. where the application or each of the applications has been withdrawn – the withdrawal of the application or of the last of the applications to be withdrawn; or

b. in any other case – the decision of the Court on the application or applications.

Taiwan

1. Is there any prohibition on a company incorporated in Taiwan providing Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

Regulatory restrictions on a company in providing Financial Assistance vary, depending on the type of Financial Assistance. This may be analysed and discussed from three aspects, as follows:

Providing loan to the acquirer

According to Article 15 of the Company Law and the Regulations Governing Loaning of Funds and Making of Endorsements/Guarantees by Public Companies (the "**Regulations**"), a company is prohibited from lending to any of its shareholders or any other person, except in the following circumstances:

(a) where an inter-company or inter-firm business transaction calls for such lending arrangement; or

(b) where an inter-company or inter-firm short-term financing facility is necessary.

The borrower should be a "company". A company is prohibited from lending money to a natural person. The amount of such financing facility shall not exceed 40% of the net worth of the lending company. The responsible persons of a lending company (such as the directors, the supervisors and the managers) who violate such regulatory restrictions shall be liable, jointly and severally, with the borrower, for repayment of the loan and the damages to the lending company resulting therefrom.

There is no further provision or government interpretation, which provides explanation to clarify the abovementioned two exceptions.

However, it is unlikely that the provision of a loan by a company to the acquirer would be deemed as within the exceptions.

Providing a guarantee or collateral to secure the obligations of the acquirer

(a) According to Article 16 of the Company Law, a company shall not act as a guarantor of any nature, unless otherwise permitted by any other law or by its articles of incorporation.

(b) Pursuant to Article 5 of the Regulations Governing Lending of Funds and Making of Endorsements/Guarantees by Public Companies, a public company may make endorsements/guarantees or provide collateral to secure the obligation of the following companies:

   (i) a company with which it does business

   (ii) a company in which the public company directly and indirectly holds more than 50% of the voting shares

   (iii) a company that directly and indirectly holds more than 50% of the voting shares in the public company

Companies in which the public company holds, directly or indirectly, 90% of the voting shares may make endorsements/guarantees for each other, provided that the amount of endorsements/guarantees can not exceed 10% of the net value of the endorser/guarantor. Companies in which the public company holds 100% of the voting shares are allowed to make endorsements/guarantees for each other without the aforesaid 10% restriction.

Where a public company fulfils its contractual obligations by providing mutual endorsements/guarantees for another company in the same industry for purposes of undertaking a construction project, or where shareholders make endorsements/guarantees for their jointly invested company in proportion to their shareholding percentages, such endorsements/guarantees may be made free of the restrictions set out under (b).

(c) Therefore, generally, a private company may provide a guarantee or collateral to secure the obligations of the acquirer if the articles of incorporation do not provide any restrictions; a public company may provide a guarantee or collateral for the obligations of the acquirer which owns 50% of its voting shares.

We have found that certain companies set forth a maximum amount of guarantee and endorsement that they may provide to others in their articles of incorporation or internal rules relating to guarantees and endorsements. In case the accumulated amount of guarantees and endorsements exceeds such maximum amount, a shareholders' meeting must be convened to amend the articles of incorporation and such internal rules.

2. What are the implications under the corporate benefit laws of Taiwan for a company providing Financial Assistance?

In Taiwan, directors and managers of a company have a duty to act in good faith for the benefit of the company as a whole and for a proper purpose. This duty is prescribed under the Civil Code as well as under Article 23 of the Company Law.

As this duty also applies to dealings between companies in a corporate group, when considering providing Financial Assistance for the acquisition of a company's shares, directors and the managers in charge of such Financial Assistance must continue to act in good faith for the benefit of that company.

As explained under Question 1 above, given that the exceptions to the Regulations do not apply, a company is not permitted to provide a loan to a party that intends to acquire shares in such company or in its parent company. The director in violation of such regulatory restrictions shall be liable, jointly and severally, with the borrower, for repayment of the loan and the damages to the lending company resulting therefrom.

With regard to other types of Financial Assistance, it is essential that the director and the manager in charge of such Financial Assistance comply with their fiduciary duty and the obligation to act in good faith.

Since it may be difficult to determine whether the director or the manager acts for the benefit of the company, it is generally recommended that the company pass a board resolution or hold a shareholders' meeting, as the case may be, to approve such Financial Assistance.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarisation, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The most typical types of securities taken in acquisition finance transactions over property in Taiwan include:

(a) pledge created over shares;

(b) mortgages created over real property or certain movable properties (such as machines and equipment); and

(c) pledge and other lien created over other assets.

Certain liens over the assets of a company must be registered with the competent authorities or registration agent. Failure to register, if required, may make the lien invalid or will affect the enforceability and priority of that lien.

For example, with respect to the share of an unlisted or a non-OTC company, the share pledge must be registered with the company; with respect to the shares of a listed or a OTC company, the pledge must be registered with the Taiwan Depository and Clearing Corporation, which is a custodian of listed and OTC stocks. Without such registration, the share pledge will not be effective against third parties.

Mortgages created over real property must be registered with the relevant government land office.

For certificates of time deposits, the pledge must be notified to the deposit bank. No registration is required.

Generally, there are no stamp duties levied on securities documents, such as pledge agreement and mortgage agreement. The registration fees for collateral other than real property are quite minimal – between US$0 and US$40. However, the registration fee for real property is 0.1% of the mortgage amount, which can be a significant amount if the mortgage amount is high. Such registration fees are generally paid by the mortgagor or the borrower.

4. How long, following acquisition of a foreign target company, would it usually take in Taiwan for a local subsidiary of such company to grant a guarantee/ security?

This will depend on the group structure of the Taiwanese target company, the number of Taiwanese subsidiary companies involved, whether the Taiwanese parent company or the Taiwan subsidiary is a public company or not, and whether the Articles of Incorporation provide any specific requirements for such Financial Assistance.

In case a board resolution is required, the board of directors' meeting may be held on the same day the acquisition is completed. Registration of the pledge or mortgage may take one to three days, depending on the type of securities.

In case approval at the shareholders' meeting is required, the duration is from 15 days to 75 days, depending on whether the company is a public or private company, whether it is a general shareholders' meeting or a special shareholders' meeting.

5. Are there any restrictions on foreign banks lending to companies in Taiwan? Are interest payments to foreign banks typically subject to withholding tax?

Banking business in Taiwan

Banking services are highly regulated and focused on protecting customers. Only authorised financial institutions may provide banking services, and they are subject to close monitoring by the regulatory authorities, such as the Financial Supervisory Commission ("**FSC**") and the Central Bank of China (Taiwan) ("**CBC**").

Restrictions on foreign banks in Taiwan

In general, in Taiwan, a bank may not engage in a marketing activity if it does not have a banking licence or a FSC approval. If a foreign bank wishes to conduct a banking business in Taiwan, it must first be recognised by the Taiwan government and establish a branch in Taiwan in accordance with the Company Law and the Banking Act. The rules for the establishment and operation of foreign banks prescribed by the FSC are the Regulations Governing Offshore Bank Branches and Representative Offices ("**Foreign Banks Regulations**").

Restrictions on foreign banks lending from abroad

If a foreign bank extends loan directly from abroad but does not physically conduct any banking business, including marketing and liaison services, in Taiwan, such bank is not required to obtain approval from the FSC and establish a branch or liaison office in Taiwan.

Interest payments and withholding tax

The interest payment to a foreign bank without any branch office in Taiwan is subject to 20% withholding tax imposed by the Taiwan tax authorities. However, as Australia, Belgium, Denmark, Gambia, Indonesia, Macedonia, Malaysia, New Zealand, the Netherlands, Singapore, South Africa, Senegal, Sweden, Swaziland, the UK and

Vietnam have tax treaties with the Taiwan government, the interest payment made to an entity established in those countries is subject to a lower rate (most of them being 10%) of withholding tax.

6. If a takeover bid which relies on bank debt is made for a publicly listed company in Taiwan, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Tender offer regulation

According to Article 43-1 of the Securities and Exchange Act of Taiwan, the FSC promulgated the Regulations Governing Tender Offers and the Regulations Governing Mandatory Disclosure in Tender Offer Prospectus (collectively, "**Tender Offer Regulations**"). The Tender Offer Regulations require that certain information relating to an offeror's funding be disclosed in the tender offer prospectus which is to be filed with the FSC and distributed to the target company's shareholders.

Such information includes, among other things, the source of funding (e.g. the offeror's own funds and/or financing from banks in Taiwan). According to the Tender Offer Regulations, if any financing will be used for the tender offer:

(a) the tender offer prospectus shall provide a detailed financing and repayment plan, including the source of the borrowed funds and the primary borrower(s); and

(b) if the target company's assets will be used as collateral for the loans granted to the offeror, the prospectus shall disclose the terms of such security.

Condition to close tender offer

According to the Tender Offer Regulations, the conditions to close the tender offer are limited to the minimum tender condition (i.e. the tender offer will not be closed until certain amounts of target's shares have been tendered) and the regulatory approval condition (e.g. antitrust clearance and foreign investment approval). In other words, the regulators do not accept the obtaining of sufficient financing as one of the offeror's conditions to close the tender offer. Please note that if the offeror is unable to obtain sufficient financing and fails to close the tender offer, it will be held liable for the losses suffered by the target's shareholders who have accepted the offer.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Liquidation

Where normal liquidation is initiated by the insolvent company, all debts and claims reported to the liquidators within three months after public announcement by the liquidators may be admitted as "Liquidation Claims". During this reporting period, Article 328 of the Company Law provides that the insolvent company may repay the secured creditors (such as a real property mortgage or a pledge over the company's movable assets) without obtaining prior approval from the court.

If the property of the company is clearly insufficient to meet all debts and claims, the court will order a special liquidation accordingly. Article 340 of the Company Law provides that under a special liquidation proceeding, all the debts and claims of the insolvent company shall be paid proportionately. However, Article 340 of the Company Law further provides that the secured creditors and the creditors with preferential repayment rights (e.g. maritime lien) are not subject to the special liquidation (not stayed by the liquidation proceeding) and are entitled to be repaid in advance.

Whether or not a company is under a normal or special liquidation proceeding, debt holders are given priority over equity holders by law.

Reorganisation

The regulatory regime for a company's bankruptcy in Taiwan is set forth under two laws, namely, the Company Law and the Bankruptcy Law. The Reorganisation Chapter of the Company Law provides a regulatory regime similar to that in Chapter 11 of the US Bankruptcy Code. On the other hand, the Bankruptcy Law provides a regulatory regime similar to that in Chapter 7 of the US Bankruptcy Code.

The purpose of company reorganisation is to rehabilitate an insolvent company by continuing its business and adjusting the rights and interests of its shareholders, creditors and other interested parties. If the court approves the reorganisation, all claims that existed prior to the court's decree announcing the commencement of reorganisation are claims that may be reported to the reorganisation supervisors during the reorganisation proceedings and shall be admitted as "Reorganisation Claims". However, if the claims did not exist before the commencement of reorganisation or were not reported to the reorganisation supervisors during the proceedings, no claims will continue to be legally effective and may be claimed after the reorganisation proceedings are completed.

Among the "Reorganisation Claims", there are different priorities for payment or distribution. Generally, priority is given to "Preferential Claims", "Secured Claims" and then "Unsecured Claims", elaborated as follows:

(a) "Preferential Claims" means those claims given priority by law, such as claims for taxes, claims arising out of preserving the company's business and operation and expenses arising out of the reorganisation procedure.

(b) "Secured Claims" includes claims secured by mortgage(s), pledge(s), lien(s), etc.

(c) All other claims are "Unsecured Claims".

Holders of Unsecured Claims may not recover their claims unless the Preferential Claims and the Secured Claims are first satisfied in the reorganisation proceedings. Holders of Preferential Claims, Secured

Claims, Unsecured Claims and shareholders of the Debtor Company are collectively referred to as the "**Relevant Parties**" (individually the "Relevant Party"), and each constitutes a separate class of claimants under the reorganisation proceedings. In the event that the company's net worth is negative, the shareholders as a class will have no voting rights.

8. Is interest on debt incurred to acquire a company in Taiwan deductible from earnings for tax purposes? Are there any thin capitalisation thresholds?

Interest payment

Interest payments on debt used to fund an acquisition are tax-deductible in Taiwan.

Thin capitalisation rules

In Taiwan, there are no thin capitalisation rules which limit debt deductions for companies which are geared in excess of certain thresholds.

9. Will contractual subordination be honoured by a liquidator or bankruptcy trustee in Taiwan?

Contractual subordination and negative pledge

Under the ROC Laws, the concept of freedom of contract is recognised unless any provision of contract is prohibited by the law of mandatory nature. Therefore, contractual subordination will be generally honoured by a liquidator or bankruptcy trustee in Taiwan.

Thailand

1. Is there any prohibition on a company incorporated in Thailand providing Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

In Thailand, there is no specific regulation prohibiting the extension of Financial Assistance to a person to buy out a company.

However, under Thai corporate laws (Section 1144 of the Civil and Commercial Code (governing private limited companies) and Section 85 of the Public Company Act (governing public limited companies)), directors must conduct the business of the company in accordance with the articles of association, the objectives of the company, and the resolutions of the shareholders in good faith, and in the best interest of the company. Therefore, a Thai company may enter into any transaction to provide Financial Assistance <u>only if</u> such transaction is:

(a) within the objectives of that Thai company;

(b) compliant with the articles of association of that Thai company; and

(c) not contravened by any resolution of the shareholders of that Thai company.

In practice, to ensure that the transaction is binding on the Thai company and the transaction will not be challenged, the directors will normally request the shareholders' approval or ratification of such transaction.

In addition, if the Financial Assistance is provided by a public limited company by way of the following transactions, the Public Company Act sets out certain requirements, as follows:

(a) If the Financial Assistance is provided by way of "transfer of <u>whole or important parts</u> of the business company" to the acquirer, it is required under Section 107 of the Public Company Act that such transaction be approved by the resolution of shareholders having votes of not less than three quarters of the total number of votes of shareholders attending the meeting and having the right to vote.

(b) If the Financial Assistance is provided by way of payment of dividends, such payment of dividends must be approved by the shareholders of the company with a majority vote and such dividends must be paid only out of profit of the company. If the company still has accumulated loss, then no dividends may be distributed. However, if allowed under the articles of association of the company, the board of directors may pay interim dividends to the shareholders from time to time if the board believes the profit of the company justifies such payment. In that case, after the dividends have been paid, such dividend payment must be reported to the shareholders at the next shareholders' meeting.

2. What are the implications under the corporate benefit laws of Thailand for a company providing Financial Assistance?

Thailand recognises the concept of 'Corporate Benefit' in both the Civil and Commercial Code and the Public Company Act.

The Civil and Commercial Code prescribes that the directors must, in their conduct of the business of the company, apply the diligence of a careful businessman. In particular, they are jointly responsible for:

(a) the payment of shares being actually made by the shareholders;

(b) the existence and regular keeping of books and documents as prescribed by law;

(c) the proper distribution of the dividend or interest as prescribed by law; and

(d) the proper enforcement of the resolutions of the general meetings.

However, a director must not, without the consent of a general meeting of shareholders, undertake commercial transactions of the same nature as and competing with those of the company, either on his/her own account or that of a third person, nor may he/she be a partner with unlimited liability in another commercial concern carrying on a business of the same nature as and competing with that of the company. This also applies to persons representing the directors.

Any claims against the directors for compensation for damages caused by them to the company could be entered into by the company or, in case the company refuses to act, by any of the shareholders. However, when the acts of a director have been approved by the general meeting, such director is no longer liable for the said acts to the shareholders who approved them or to the company. Shareholders who did not approve such acts could not enter their action later than six months after the date of the general meeting in which such acts were approved.

As mentioned in Question 1 above, Section 85 of the Public Company Act prescribes that in conducting the business of the company, a director of the company must act in accordance with law, the objectives of the company, the articles of association of the company, and the resolution of the shareholders' meeting in good faith and in the company's best interests. If any director fails to act as such, the company or the shareholders may act as follows:

(a) If the act or omission to act of the director causes damage to the company, the company may make a claim for damages from such director. If the company does not make the claim, shareholders holding not less than 5% of the sold shares of the company may instruct the company to do so by written notification to the company. If the company still fails to act, they may file the claim themselves on behalf of the company.

(b) If the act or omission to act of the directors causes damage to the company, shareholders holding not less than 5% of the sold shares of the company may file an injunction with the court for suspension of such act.

There are two issues to be considered.

(a) If the act of the director is an ultra vires act, i.e. outside the power of the company or prohibited under its articles of association, such act will not be binding on the company and the directors shall be solely responsible for such act unless the shareholders have approved or ratified such action.

(b) If the act of the director is within the power of the company but is not in the best interest of the company, this will not render such act void but allow the company or the shareholders the right to make a claim for damages against the directors. However, if such act, whether or not beneficial to the company, is approved or ratified by the shareholders of the company, the directors do not have any further liability to the company for such act.

As mentioned in Question 1 above, in Thailand, there is no regulation prohibiting the extension of Financial Assistance to a person to buy out a company so if the directors of a company authorise the provision of Financial Assistance for the acquisition of the company's shares and such action is allowed under the memorandum and articles of association of the company or has been approved or ratified by a resolution passed at the shareholders' meeting, such act will be binding upon the company without the directors incurring any liability.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarisation, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

At present, there are only two forms of security interest over assets recognised by Thai law: pledge and mortgage. In practice, the parties may enter into any other form of contact (e.g. assignment or option) as the contractual security arrangement which is not recognised as security interest by Thai law (in particular, the Thai Bankruptcy law).

Pledge

A pledge can be created over movable properties by physical delivery of the pledged properties to the pledgee. The negotiable instruments (e.g. bill of exchange, promissory note, cheque and negotiable certificate of deposit) can also be pledged under Thai law by way of endorsement.

For the pledge of shares, Thai law requires that the pledgor physically deliver the share certificates representing the pledged shares to the pledgee and record such pledge in the registry book. With respect to the listed shares, Thailand Securities Depository Company Limited, the registrar of all listed shares on the Stock Exchange of Thailand, has a procedure in place for the creation of pledges over shares by way of a book-entry system, which does not require the physical delivery of share certificates. Under Thai law, however, it is not clear whether the court will recognise such transaction as a pledge. We always advise the pledgees to create and perfect the pledge of shares by way of physical delivery of share certificates.

It should be noted that the pledge is automatically discharged if the pledged property is returned to the possession of the pledgor.

The pledge agreement is subject to THB 1 stamp duty for underlying obligations which the pledge secures and which do not have a specific monetary value. However, a pledge is exempted from stamp duty when the pledge secures obligations under a loan agreement in respect of which stamp duty has been paid.

Mortgage

A mortgage can be created over immovable properties. However, the following movable properties can also be mortgaged if they are registered under the relevant law:

(a) Ships or vessels of not less than 6 tons, and steam launches or motor boats of not less than 5 tons;

(b) Floating houses;

(c) Certain animals which can be used as vehicles; and

(d) Any other movables with regard to which the laws allow for the registration (e.g. machinery or cars).

The Civil and Commercial Code provides that a contract of mortgage must be made in writing and must be registered with the relevant authorities. Such contract must specify the mortgaged property and must contain, in Thai currency, a statement of a certain sum or a maximum amount which is secured by the mortgage contract.

The official mortgage registration fee will be calculated on the basis of the mortgaged property, for example:

(a) for land and building mortgages, 1% of the mortgage value but not exceeding THB 200,000 per mortgagee under each mortgage;

(b) for machinery mortgage, 0.1% of the mortgage value but not exceeding THB 100,000 per mortgage;

(c) for condominium mortgage, 1% of the mortgage value for each mortgage; and

(d) for vessel mortgage, the registration fee will be based on the size of the vessel but not exceeding THB 20,000 per mortgagee under each mortgage.

Assignment of rights

Thai law does not have a concept of security over contractual rights, except for the rights under bills and certain instruments which can be pledged as mentioned in the heading “Pledge” above.

Accordingly, granting security over rights under a contract will not be regarded as granting a security interest under Thai law (including the Thai Bankruptcy law). Nevertheless, in practice and if such contract is assumed to have been entered into by a borrower and counterparty, the security arrangement over the rights under a contract can be made by way of assignment of the right by the borrower to the lender as collateral. This arrangement is commonly used in Thailand to create the right in favour of the lender where security interest over the contractual rights is not available under the law as explained above.

4. How long, following acquisition of a foreign target company, would it usually take in Thailand for a local subsidiary of such company to grant a guarantee/ security?

This depends on the type of security and whether a Thai subsidiary granting a guarantee/security is a listed company.

In general, the quickest period in which a Thai subsidiary could provide a guarantee or security is based upon the closing of the acquisition.

Where the Thai subsidiary is a listed company, that Thai listed company is required to comply with procedures as stipulated under the Stock Exchange of Thailand (SET) Notification Re: Disclosure of Information and Act of Listed Companies Concerning the Connected Transactions (the "**Connected Transaction Rule**"), upon making a decision to enter into a transaction where such transaction is a 'connected transaction'. A transaction can be regarded as a 'connected transaction' if it is a transaction between a listed company or the listed company's subsidiary and the listed company's connected person(s); or any transaction between the listed company's subsidiary and that subsidiary's connected person(s) (the "**Connected Transaction**").

If a listed company or its subsidiary enters into the Connected Transaction, the listed company is required to comply with the prescribed duties, depending on the value of the transaction. This applies in cases where the transaction pertains to assets or services and the Connected Transaction includes Financial Assistance.

Disclosure to the SET requirements

Under the Connected Transaction Rule, a listed company is required to make different levels of disclosure, depending on the type of the transaction to be undertaken by such listed company or its subsidiary. The disclosures required by the SET are as follows:

(a) Disclosure to the SET;

(b) Notice to the Shareholders' Meeting; and

(c) Notice to the Shareholders.

Requirement of approval by the board of directors

If the transaction involves a listed company offering Financial Assistance to connected persons of less than THB 100 million or less than 3% of the net tangible asset value, the listed company is required to seek approval when entering into a connected transaction from the board of directors. The listed company must preclude directors (who have interests in making a decision to enter into a connected transaction) from attending the meeting and having voting rights at the meeting, and must disclose a resolution containing information according to Disclosure to the SET.

Requirement of approval by the shareholders

If the transaction involves a listed company offering Financial Assistance to connected persons of more than THB 100 million or more than 3% of the net asset tangible value, whichever is higher, a resolution of the shareholders' meeting approving a decision to enter into a connected transaction is required in order to approve such transaction. Such resolution must consist of at least three-fourths of the total votes of shareholders attending the meeting and having voting rights, excluding interested shareholders' equity.

In practice, the corporate approval requirement can be obtained by the seller prior to the closing of the acquisition.

5. Are there any restrictions on foreign banks lending to companies in Thailand? Are interest payments to foreign banks typically subject to withholding tax?

Restrictions on foreign banks lending in Thailand

It is not necessary under the laws of Thailand for foreign banks to be licensed or qualified to carry on lending in Thailand unless a foreign bank carries on a commercial banking business in Thailand. Under the Financial Institution Business Act B.E. 2551 (2008), 'commercial banking business' means the business of (i) accepting deposits of money subject to withdrawal on demand or at the end of a specified period and (ii) employing such money in one or several ways such as (a) granting of credits, (b) buying and selling of bills of exchange or any other negotiable instruments, and (c) buying and selling of foreign exchange.

Interest payments and withholding tax

(a) There is a withholding tax at the rate of 15% on loan interest, commitment fee, front-end fee, cancellation fee and prepayment fee payable by a Thai resident borrower to foreign lenders that are foreign companies not carrying on business in Thailand or whose permanent establishment is not involved in this lending transaction. The withholding tax will generally be reduced to 10% if such lenders are financial institutions being a tax resident of a country having a tax treaty with Thailand. There is no withholding tax on loan interest, commitment fee, front-end fee, cancellation fee and prepayment fee to lenders that are wholly owned by the Government of Japan.

(b) The agency fees payable to the agents incorporated for agency services rendered within Thailand are subject to withholding tax at the rate of 3% of the amount paid and may generally be subject to value-added tax at the rate of 7.0% of the amount paid.

(c) The agency fees payable to the agent for agency services rendered outside Thailand are generally subject to withholding tax at the rate of 15% of the amount paid. However, if an agent is a tax resident of a country having a tax treaty with Thailand, an exemption applies, provided that such agent does not have a permanent establishment in Thailand or the agency fees are not attributable to the Thai permanent establishment of such agent. The agency fees are subject to value-added tax at the rate of 7.0% of the amount paid.

Restrictions on exchange control

Where interest will be paid from a Thai resident borrower to foreign lenders, the purchase and remittance of foreign currency out of Thailand require an exchange control approval from a commercial bank operating in Thailand which is an authorised agent of the Bank of Thailand.

6. If a takeover bid which relies on bank debt is made for a publicly listed company in Thailand, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

The Securities and Exchange Act (the "**SEC Act**") and SEC Notification No. Gor Jor 53/2545 dated 18 November 2002 Re: Rules, Criteria and Procedures for Business Takeover governing the takeover of business (the "**Takeover Notification**") require a person who has acquired shares in a company up to the percentage that is significant to the change of control or management of a company (the "**Trigger Point**") to make a tender offer (the "**Tender Offer**") and comply with the Tender Offer requirements in accordance with the applicable regulations. This is to allow existing shareholders the opportunity to sell their shares upon change of control or business takeover.

The Takeover Notification basically requires an acquirer of shares in the business reaching or exceeding the Trigger Point to make a Tender Offer for all outstanding shares sold in the business (all 100% of the total shares sold), including other equity-linked securities (e.g. warrants, convertible debentures). It does not have a specific requirement that regulates the certainty of the availability of the bank debt that is relied upon for making the takeover. However, as one of the requirements under the Takeover Notification, the acquirer must submit the tender offer in accordance with the form prescribed by the Office of the SEC (Form 247-4) to the public. Under that form, there is a requirement for the acquirer to state the source of the funds that will be used for making such offer. If such funds come from bank debt, the acquirer will have to provide the following information:

(a) the name of the financial institution that will be providing the funds;

(b) the provision on the cancellation of the funds (if any); and

(c) if the source of the repayment of the funds is the target company, the acquirer has to specify the term of repayment and the method by which the funds for repayment will come from the target company (i.e. dividend from the target company or loan granted from the target company), including the effect that this will have on the target company, e.g. the target company will have to dispose of some of its assets in order to make the dividend payment or to grant such loan to the acquirer, etc.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

In Thailand, debt holders are given priority over equity holders. Only the 'creditor' can file a claim for repayment of debt in bankruptcy.

The secured creditor will have rights over the asset which is the security given to it by the debtor prior to the insolvency.

Among the unsecured creditors, Section 130 of the Bankruptcy Act prescribes that the assets shall be paid in the following order:

(a) Expenses for the administration of a deceased debtor's estate;

(b) Expenses of the receiver in managing the debt's assets;

(c) Funeral expenses of a deceased debtor proper to his/her status;

(d) Fees for collecting assets in case of an appeal with regard to a claim for payment of debt;

(e) Fees of the petitioning creditor and counsel's fee as the court or the receiver may prescribe;

(f) Taxes which have become due for payment within six months prior to the insolvency and wages; and

(g) Other debts.

If the money is insufficient to pay the debt in any series above in full, the creditors in such series shall be paid *pari passu*.

8. Is interest on debt incurred to acquire a company in Thailand deductible from earnings for tax purposes? Are there any thin capitalisation thresholds?

Interest payments on debt used to fund an acquisition are generally tax-deductible in Thailand, with some exceptions.

There is no thin capitalisation rule under Thai law.

9. Will contractual subordination be honoured by a liquidator or bankruptcy trustee in Thailand?

The Bankruptcy Act prescribes the order of distribution of the assets among the creditors as already mentioned in Question 7 above. In addition to such order of priority, the Bankruptcy Act recognises contractual subordination. Section 130 bis of the Act prescribes that "in case where any debt under Section 130(7) (other debts) is required by law or by contract that a creditor shall have the right to receive repayment only after other creditors have received repayment in full, such creditor shall remain entitled to a distribution of the assets in accordance with the rights to which he is entitled pursuant to such law or contract".

As such, Thai law does recognise the concept of contractual subordination and such shall be honoured by a liquidator upon bankruptcy.

Vietnam

1. Is there any prohibition on a company incorporated in Vietnam providing Financial Assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

The Civil Code, the Enterprise Law and the Ordinance on Foreign Exchange are the main legal documents governing the provision of Financial Assistance by a company to any other entity. In general, the Civil Code and the Enterprise Law do not prohibit the provision of Financial Assistance by a company to a person for acquiring shares[1] in that company or its parent company. However, if the person who is obtaining the Financial Assistance is considered a *related person* of the company, a number of conditions must be satisfied before the Financial Assistance can be provided.

A 'related person' is defined as an organisation or individual having a direct or indirect relationship with an enterprise in the following ways:

(a) The parent company, the manager of the parent company, and the person having the authority to appoint that manager vis-à-vis a subsidiary;

(b) A subsidiary vis-à-vis a parent company;

(c) A person or a group of persons capable of controlling the decision-making and/or activities of the enterprise through the enterprise's managerial bodies;

(d) The enterprise manager;

1 Under Vietnamese law, only a joint stock company can issue shares. Other corporate forms such as single-member limited liability companies and multi-member limited liability companies are not permitted to issue shares. This paper discusses the possibility of provision of Financial Assistance in relation to joint stock companies and limited liability companies.. For limited liability companies, 'shares' will be understood as 'capital contribution'.

(e) The wife, husband, father, adoptive father, mother, adoptive mother, children, adopted children, [and] biological siblings of the enterprise manager or of the member owning a controlling capital contribution portion or of the shareholder holding controlling shares;

(f) An individual authorised to represent a person provided in point a, b, c, d or e above;

(g) An enterprise in which a person provided in point a, b, c, d, e, or f above or h below holds an ownership reaching a level sufficient to control the decision-making of its managerial bodies; or

(h) A group of persons who agree to collaborate jointly in order to take over capital contribution portions, shares or interests in a company, or to control the decision-making of a company.

As required in the Enterprise Law, if the person who obtains the Financial Assistance is considered a *related person* of the company, approval at the General Meeting of Shareholders ("**GMS**") or the Board of Management[2]/Board of Members[3] must be obtained before the Financial Assistance can be provided.

The requirement of GMS or BOM approval is set out in Articles 59(1), 75(1) and 120 of the Enterprise Law.

For single-member limited liability companies

The case must be considered and approved by the Board of Members or company President, Director or General Director, and Controller(s) in accordance with the principle of the majority, each possessing one vote.[4]

2 i.e. the Board of Management of a joint stock company.

3 i.e. the Board of Members of a single-member limited liability company or multi-member limited liability company.

4 Article 75 of the Enterprise Law.

For multi-member limited liability companies

The case must be examined and approved by the Board of Members. The principle is that the case must be approved by a number of members representing at least 75% of the total amount of voting capital. The member involved in that transaction is not entitled to cast a vote on the case.[5]

For joint stock companies

Any Financial Assistance between the company and any of the following entities must be approved by the GMS or the Board of Management:

(a) A shareholder, or an authorised representative of a shareholder, owning more than 35% of the total number of the common shares of the company or his/her/its related persons;

(b) A member of the Board of Management or the Director or General Director; or

(c) Enterprises in which the members of the Board of Management, members of the Control Committee, Director or General Director, and other managerial personnel of the company ("**managerial personnel**") own a capital contribution portion or shares, or enterprises in which the managerial personnel's related persons, together or separately, own a capital contribution portion or shares amounting to more than 35% of the charter capital.

In such a case, the issue must be considered and approved by the GMS or the Board of Management. In case the Financial Assistance is less than 50% of the total value of the enterprise's assets stated in its most recent financial statements, the matter will be determined by the Board of Management. The GMS has the power to approve other transactions except for those under the Board of Management's power. If the matter is within the GMS's jurisdiction, the matter will be approved when it has the consent of the number of shareholders representing 65% of the total number of the remaining votes.

5 Article 59(1) of the Enterprise Law.

As a general rule, Financial Assistance will be invalidated and dealt with in accordance with provisions of law when it is entered into or performed without having been approved in accordance with the rules described above. The representative at law of the company and the relevant shareholder, a member of the Board of Management, or Director or General Director, and their related persons must pay compensation for damage that arises and return to the company gains generated from performing the transaction.[6]

Further, if the Financial Assistance relates to the remittance of money out of Vietnam, a review of the regulations on foreign exchange should be considered.

2. What are the implications under the corporate benefit laws of Vietnam for a company providing Financial Assistance?

In general, managerial personnel of a company have a duty to act in good faith for the benefit of the company as a whole and for a proper purpose. This duty arises under the provisions of the Enterprise Law.

For single-member limited liability companies

A member of the Board of Members ("**BOM Member**"), the company President, the Director or General Director, and the Controller(s) are obliged to:

(a) comply with the law, the company Charter, and the decisions of the company owner in exercising the authority and performing the duties delegated to them; and

(b) exercise the authority and perform the duties delegated to them in an honest, prudent and best manner, in order to assure the maximum legal interests of the company and the company owner.

6 Articles 59(2), 75(3), and 120 (4) of the Enterprise Law.

For multi-member limited liability companies

A BOM Member and the Director or General Director are obliged to:

(a) exercise the authority and perform the duties delegated to them in an honest, prudent and best manner, in order to assure the maximum legal interests of the company and the company owner; and

(b) act in a fiduciary capacity for the benefit of the company and the company owner; refrain from making use of the information, know-how and business opportunities of the company; and refrain from abusing their title or position or the company's property for personal gain or for serving the benefit of another organisation or individual.

For joint stock companies

The members of the Board of Management ("**BOMG Member**"), the Director or General Director, and other managerial personnel are obliged to:

(a) exercise the authority and perform the duties delegated to them in strict compliance with relevant laws, the company Charter and the resolutions of the General Meeting of Shareholders;

(b) exercise the authority and perform the duties delegated to them in an honest, prudent and best manner, in order to assure the maximum legal interests of the company and the company's shareholders; and

(c) act in a fiduciary capacity for the benefit of the company and the company's shareholders; refrain from making use of the information, know-how and business opportunities of the company; and refrain from abusing their title or position or the company's property/assets for personal gain or for serving the benefit of another organisation or individual.

In performing its functions and duties, the Board of Management must comply strictly with the provisions of law, the company Charter and the resolutions of the GMS.

In the event that a resolution adopted by the Board of Management is inconsistent with the provisions of law or the company Charter, thus causing damage to the company, the BOMG Member(s) who approved that resolution must take jointly personal liability for that resolution and compensate the company for the damage; the BOMG Member(s) who objected to that resolution are exempt from liability.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarisation, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The most typical types of security taken in Acquisition Finance transactions over property in Vietnam include (collectively referred to as "**secured transactions**"):

(a) for shares[7] and share mortgages;

(b) for land use rights ("**LURs**") and assets attached to land, including future assets (building under construction), real property mortgages; and

(c) for moveable assets, asset mortgages or pledges.

LURs cannot be mortgaged to an offshore entity. Mortgages over real property (LURs and assets attached to land) must be notarised at a notary office and then registered with the land registry under the provincial-level Department of Nature, Resources and Environment.

For assets that require ownership registration, such as shares, the business registration and/or investment authority will have to approve any transfer of these assets to a third party.

7 Charter capital, share and equity in this context have been referred to as 'share'.

By law, or if parties to a secured transaction agree to the requirement, certain secured transactions must be registered with a competent state agency to be valid. Failure to register, if required, will affect the enforceability and priority of such security.

The law requires that secured transactions be in written form. Under certain circumstances, notarisation and registration of secured transactions are required in order for the secured transactions to be valid and enforceable.[8] However, registrations of secured transactions are recommended, even when they are not required, in order to secure priority of payment if enforcement takes place where an asset is secured by more than one obligation.

Following are two common stamp duties relating to the notarisation and registration of secured transactions:

(a) The notarisation fee is levied on the value of secured assets or value stated in secured agreements, but the maximum fee applicable is ten million Vietnam Dong (VND 10,000,000)[9]; and

(b) The registration fee of each secured transaction is sixty thousand Vietnam Dong (VND 60,000).

Stamp duty is a type of fee or tax under Vietnamese law which is levied on many documents, including loan securities. The rates of stamp duty vary depending on the nature of the transaction and the nationality of the parties involved. Specialised advice on the stamp duty aspects of each particular transaction should be obtained.

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8 Articles 9 and 10 of Decree No. 163.

9 Joint Circular No. 91/2008/TTLT-BTC-BTP of the Ministry of Finance and the Ministry of Justice dated 17 October 2008 guiding the rates and the collection, remittance, management and use of notarisation fees.

4. How long following acquisition of a foreign target company would it usually take in Vietnam for a local subsidiary of such company to grant a guarantee/ security?

This depends on the number and group structure of the Vietnamese target subsidiary companies involved, and whether any Vietnamese parent company is a joint stock company/public company or not. The joint stock company must obtain shareholder consent to grant a guarantee/security.

5. Are there any restrictions on foreign banks lending to companies in Vietnam? Are interest payments to foreign banks typically subject to withholding tax?

There are no restrictions applicable to foreign banks lending to companies in Vietnam, but there are restrictions applicable to companies established in Vietnam borrowing from overseas (e.g. loans from foreign banks) (hereinafter referred to as "**offshore loans**"), as follows:

Offshore loans borrowed by enterprises and economic organisations belonging to the public sector ("State-owned enterprises")

State-owned enterprises shall be permitted to obtain offshore loans directly in the form of independent borrowing and bear self-responsibility for repayment to the foreign lenders in accordance with the conditions and undertakings in the loan agreements.

The Government shall not be liable for debts arising from offshore loans obtained directly by State-owned enterprises, except for loans guaranteed by the Government and as stipulated in Section 2 of Chapter III of Decree No. 134/2005/ND-CP of the Government on control of foreign loans and loan repayments.

All medium- and long-term foreign commercial loans obtained by State-owned enterprises must be within the annual overall quota on foreign commercial loans approved by the Prime Minister of the Government; they must satisfy the conditions on medium-term and long-term loans stipulated by the State Bank of Vietnam ("**SBV**") from time to time; they must be registered with and confirmed by the SBV; and there must be periodic reports made to the SBV on the status of drawdown, capital utilisation and loan repayment in accordance with the reporting regime stipulated by the Governor of the SBV.

Where a State-owned enterprise borrows foreign loan capital by way of issuance of international bonds, it must prepare a plan for the issuance and obtain appraisal opinions from the Ministry of Finance and the SBV prior to submission thereof to the competent body for approval.

All short-term foreign commercial loans obtained by State-owned enterprises must be within the annual overall quota on foreign commercial loans approved by the Prime Minister of the Government and must satisfy the conditions for short-term loans stipulated by the Governor of the SBV from time to time.

Drawdowns and transfers of money for repayment of offshore loans by State-owned enterprises shall be made through banks operating in the territory of Vietnam which are authorised to conduct foreign exchange transactions, except for drawdowns to make direct payments to foreign suppliers. If a drawdown or loan repayment in the form of goods or assets (whether such assets are tangible or intangible) is not made through a bank, the enterprise shall submit a report thereon in accordance with the regulations of the SBV, and where necessary, the opinion of the State administrative body for the relevant industry or sector will be required.

State-owned enterprises obtaining offshore loans are responsible for using loans for proper purposes, shall not be permitted to use short-term loans for investment in long- or medium-term projects, shall make repayments (of both principal and interest) in accordance with undertakings in the loan agreements signed with foreign lenders, and shall themselves bear all risks and responsibilities before the law of the State during the course of loan drawdown and repayment.

In the case of medium-term and long-term loans of State-owned enterprises, banks shall only be permitted to make disbursements and transfers of money for loan repayment to foreign lenders where such loans have been registered in accordance with regulations.

The SBV shall co-ordinate with the Ministry of Finance to provide detailed guidelines on procedures for control of offshore loans and loan repayment by State-owned enterprises.

Offshore loans borrowed by enterprises and economic organisations belonging to the private sector ("Private Enterprises")

All offshore loans obtained by private enterprises shall be subject to supervision and monitoring by the Government. The SBV is the body representing the Government in the exercise of its supervision and monitoring functions.

Private enterprises must register loans with the SBV after signing loan agreements with the foreign lenders and must implement the reporting regime stipulated by the Governor of the SBV.

Private enterprises utilising foreign loan capital shall themselves be fully liable to repayments in accordance with the undertakings in loan agreements, the laws of Vietnam and international practice in law.

In the case of long- and medium-term loans of private enterprises, domestic banks shall be permitted to make disbursements and transfers of money only for loan repayment to foreign lenders where such loans have been registered in accordance with regulations.

Offshore loan registration

Medium- and long-term offshore loans (i.e. the loan term is more than one year) must be registered with the SBV within 30 working days from the date of signing of the loan agreement and prior to a drawdown.

In case of extension of a short-term loan whereby the total duration of the original short-term loan plus the extension is more than one year, the enterprise must conduct registration with the SBV within 30 working days from the date of signing of the contract for extension.

In case of any changes regarding details of the offshore loans which are registered by the SBV, re-registration of such details with the SBV must be completed.

Loan drawdown and repayment

The transactions of drawdown and repayment of offshore loans of enterprises may be carried out only through one authorised bank, except for a number of transactions (where the authorised bank does not provide guarantees or services), as follows:

(a) Drawdowns for direct payment to foreign beneficiaries in respect of imported goods and services;

(b) Drawdowns and debt repayment through accounts of enterprises opened overseas (where enterprises are permitted to open overseas accounts); and

(c) Drawdowns in the form of import of goods and services with deferred payment and debt repayment in the form of export of goods and services.

Where enterprises are carrying out drawdowns and debt repayment through one authorised bank but wish to work with another authorised bank, they must finalise the transactions of drawdown and debt repayment at the former bank. In the case of medium-term and long-term loans, enterprises must register with the State Bank the change of the bank to provide the services of drawdown and debt repayment.

Withholding tax

Interest payments to foreign banks are subject to withholding tax. The current tax rate is 10% per the amounts paid to foreign banks.

6. If a takeover bid which relies on bank debt is made for a publicly listed company in Vietnam, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Vietnamese law does not have any specific provisions regarding the availability of bank debt when a takeover bid is made for a publicly listed company. However, requirements include, among others, where financing agreements, that such agreements:

(a) are notified and a copy provided to creditors;

(b) are subject to approvals, if any, provided in loan agreements;

(c) are on a 'best endeavour' basis; and

(d) are subject to satisfaction or waiver of conditions precedent.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Where a decision to commence liquidation has been issued, funds are to be distributed in order of priority of payment, according to the following hierarchy:[10]

(a) fees and costs of the bankruptcy proceedings;

(b) unpaid wages, and the like, to employees;

(c) unsecured debts payable to the creditors, according to the ratio of debts owed; and

10 Article 37 of the Law on Bankruptcy.

(d) if funds remain after the above, these will be owned by the owners' partners, shareholders or members of the enterprise or co-operative.

Based on the above, debt holders are given priority over equity holders by law in terms of payment upon insolvency of the company.

8. Is interest on debt incurred to acquire a company in Vietnam deductible from earnings for tax purposes? Are there any thin capitalisation thresholds?

There used to be a thin capitalisation rule for foreign-invested companies. Under the former Law on Foreign Investment, now repealed, the minimum legal capital (now referred to as the charter capital under the current law) was 30% of the investment capital. The current Enterprise Law and Investment Law now have no requirement on the minimum percentage or amount of charter capital (except for certain special industries such as insurance, banking or real estate, etc., where the law sets forth the required minimum amount of charter capital). However, late contribution of charter capital will lead to non-deductibility of loan interest expense to some extent, as discussed further below.

Interest expense for loan capital payable to credit institutions is fully deductible if the loans are properly supported by loan agreements, where the interest payment is based on the interest rates in the loan agreements, and where offshore medium-term and long-term loan agreements are duly registered with the SBV.

Tax law, however, provides that interest payments are not deductible where "interest payments [are] for loans used to contribute charter capital or interest payments [are] for loans corresponding with the shortage of the registered charter capital even in the case [where] business establishments have been in business operations".[11]

11 Circular No. 130/2008/TT-BTC of the Ministry of Finance dated 26 December 2008, guiding the implementation of Law No. 14/2008/QH12 on Enterprise Income Tax Law, and Decree No. 124/2008/ND-CP of the Government dated 11 December 2008, stipulating in detail the implementation of the Enterprise Income Tax Law – Point C.IV.2.15.

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Therefore, if the charter capital which is supposed to be the investor's equity is funded by loans, the loan interest expense will not be deductible. Similarly, if the contribution of the charter capital is behind the committed schedule, the interest expense for the loan amount corresponding to the shortage of the charter capital will not be deductible as well. For example, an investor commits USD 5 million of the charter capital within six months after the issuance of the Investment Certificate, but in reality, the investor has been able to contribute only USD 4 million of the charter capital within the six-month period, and in this period, the company borrows a loan of USD 3 million. As a consequence, the interest expense with respect to the loan amount of USD 1 million will not be tax-deductible, since it is deemed the interest expense for the loan amount to cover the shortage of the committed charter capital.

Based on the above, interest incurred on debts to acquire the charter capital (equity capital) of a company will not be tax-deductible.

9. Will contractual subordination be honoured by a liquidator or bankruptcy trustee in Vietnam?

Under Vietnamese law, secured debts and obligations have a priority right to payment by secured assets, and non-secured debts or subordinated debts will be treated on a *pari passu* basis.[12]

The law stipulates that debts of the dissolved enterprise shall be paid according to the following order[13]:

(a) debts in salaries, severance pays and social insurance under the provisions of law and other benefits of its employees under the executed collective labour agreement and employment contracts;

(b) debts in taxes; and

(c) other debts.

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12 Articles 35 and 37(1)(c) of the Law on Bankruptcy.

13 Article 158(4) of the Law on Enterprise and Article 37 of the Law on Bankruptcy.

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