M&A Report 2019

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INTERNATIONAL FINANCIAL LAW REVIEW

TAIWAN

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MARKET OVERVIEW

Continuing with the momentum at the end of 2017, 2018 was a fruitful year for the M&A market in Taiwan which featured prominent acquisitions in the energy sector and a strong comeback for private equity (PE) investors.

One of the most notable transactions by private equity funds was the privatisation of LCY Chemical Corporation (a leading petrochemical manufacturer previously listed on the Taiwan Stock Exchange) by a consortium led by global PE fund KKR. Morgan Stanley's acquisition of Microlife Corporation was another conspicuous transaction by a private equity fund. It is also noteworthy that these two cases, as well as several other acquisitions led by financial (PE fund) or industrial investors, were cash-out share exchange deals under the Enterprise Mergers and Acquisitions Act (M&A Act), under which a buyer acquires 100% of the shares in a target company by offering cash to the target's shareholders (similar to a cash-out merger).

Another major trend is the emergence of activity in the renewable energy sector, which parallels the Taiwanese government's policy to promote green energy. One of the most recent transactions saw Macquarie Group and Swancor Renewable Energy, two of the three shareholders of the Taiwanese offshore wind farm Formosa I, enter into definitive agreements to sell 25% and 7.5% of the equity interests in Formosa I, respectively, to JERA, a joint-venture between two large Japanese utility companies, Tokyo Electric Power and Chubu Electric Power. JERA will acquire a total stake of 32.5% in Formosa I and become the second largest shareholder of Formosa I. It is expected that more shareholders of offshore wind farm projects in Taiwan will plan to release parts of their equity interest.

In 2018, there were also various acquisition projects involving large and small-scale solar energy plants.

M&A activity

There were more M&A transactions in 2018 than in 2017 and the total value of the transactions increased by $1.7 billion.

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According to Bloomberg's M&A Legal League Table Rankings, the total value of announced transactions in 2017 was $17.13 billion with a deal count of 202, while the total value of announced transactions in 2018 was $18.86 billion, with a deal count of 231.

Following the XPEC incident, the authorities have increased the financial burden on tender offerors

Both private and public M&A transactions drive the M&A market in Taiwan. While there were some notable public M&A transactions in 2017 and 2018, there have been quite a few private M&A transactions in the market as well. For example, there have been several acquisitions in the media industry, targeting system operators, and the energy sectors, and smaller M&A deals for emerging technology companies. There may have been fewer investments by PRC/PRC-invested companies in Taiwanese companies through M&A due to the change of political climate and the sensitive cross-strait situation.

TRANSACTION STRUCTURES

There have been several driving forces in the structuring of M&A deals in Taiwan. For example, given that the newly amended M&A Act (2016) allows more flexibility in terms of the form of the consideration that an acquirer may offer to the shareholders of a target company, it should be easier for an acquirer to achieve a 100% equity interest acquisition. This was evidenced by the increasingly popular cash-out share exchange structure in 2017 and 2018. Meanwhile, given the sensitivity of PRC investments in Taiwan, acquirers and targets are also spending more time structuring their transactions to meet local restrictions/requirements regarding PRC investment, as well as their commercial goals.

Furthermore, following the XPEC incident, the authorities have increased the financial burden on tender offerors; thus, after the amendment to the relevant laws, a tender offeror of a public company may need to substantiate its financial plan much earlier than before. Due to this new financial burden, how an acquirer may structure to avoid a tender offer, to the extent possible, has become one of the key considerations for proposed buyers of public companies. That being said, we did not observe a significant drop in the number of tender offers launched in 2017 or 2018.

Financial investors

During the last decade, major M&A in Taiwan has been mostly driven by strategic investors. Financial investors have usually participated in M&A as co-investors or as acquirors of minority stakes in companies.

Nevertheless, in 2018 we saw a booming trend of financial investors returning to the market after being silent for almost a decade. A series of deals including KKR's take-private acquisition of LCY, Morgan Stanley's take-private acquisition of Microlife, Blackrock's acquisition of a solar portfolio from J&V Energy Technology and Permira's investment into aquaculture company Grobest were all led by private equity funds.

Recent transactions

KKR's take-private of LCY via a cash-out share exchange drew the public's attention not only because it was one of the highest-profile

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deals in 2018 in terms of deal size (approximately $1.56 billion) but also because LCY had been listed on the Taiwan Stock Exchange with quite a large number of shareholders. There were heated discussions on how much information the buying consortium should disclose to the shareholders during different phases of the transaction for a share exchange deal under the M&A Act. The public has since called for amendments to the M&A Act and the relevant regulations to set more stringent disclosure requirements.

Morgan Stanley and associated firms' acquisition of a controlling interest in and delisting of medical device manufacturer Microlife, for around $302 million, was also a symbolic deal that illustrated one of the trends in Taiwan's M&A market in 2018: the acquisition of companies through a cash-out share exchange by private equity funds. Both the LCY and Microlife transactions seem to signal an increasing tendency for public companies to go private.

There have since been recommendations for more stringent disclosure and voting requirements for cash-out deals and delistings. Interpretation No. 770 was rendered by the Justices of the Constitutional Court in November 2018 as regards the concerns with the inadequacy of certain provisions on disclosure under the M&A Act. Several government agencies have launched initiatives to refine and amend the regulatory scheme for cash-out and delisting transactions.

Another landmark case involved MBK Partners, which after several attempts to exit investments spanning a decade, divested its equity interests in 12 cable television system operators and other group companies affiliated with China Network Systems, the largest cable television and broadband multiple-systems operator in Taiwan with a total enterprise value of approximately $1.72 billion.

LEGISLATION AND POLICY CHANGES

The main statutes governing M&A activity in Taiwan are the M&A Act, the Company Act, the Securities and Exchange Act and the Fair Trade Act. In addition, under the Securities and Exchange Act, a set of tender offer rules are prescribed to govern tender offers of public companies. Other statutes may also be relevant, for example the Labour Standards Act, foreign and PRC investment regulations and tax laws and regulations.

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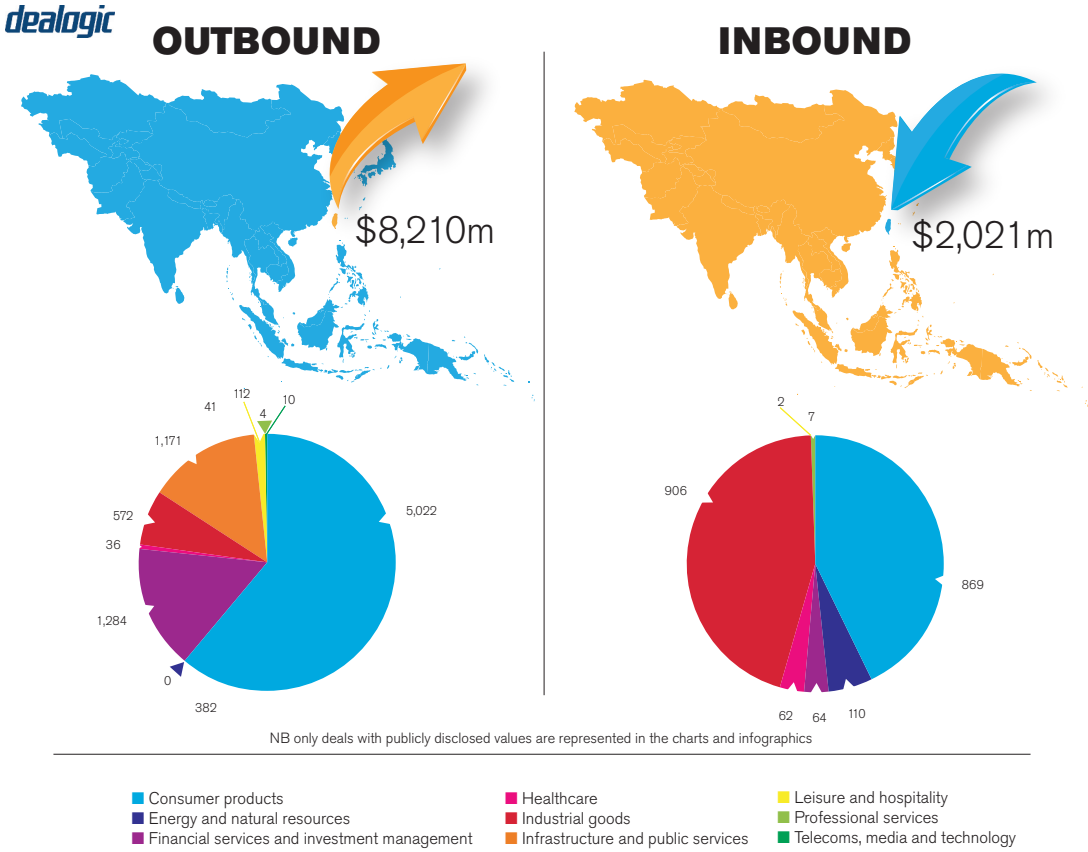
The main regulatory body in charge of public M&A transactions is the Securities Futures Bureau (SFB) of the Financial Supervisory Commission (FSC), which is the government agency responsible for public companies. The other relevant regulatory bodies include the Fair Trade Commission (FTC), the authority in charge of anti-trust clearance, and the Investment Commission (IC), the authority in



charge of reviewing foreign and PRC investments. If the target holds any special licence, the authority in charge of that special licence may also need to review the transaction.

Recent changes in law

The 2016 amended M&A Act offers more flexibility in terms of the types of consideration that an acquirer is allowed to offer in statutory M&A transactions, such as a share exchange. It also reinstates the possibility of structuring a triangular merger under the Taiwanese legal system. Since the amendment, we have seen a series of M&A transactions that adopted the new cash-out share exchange structure in order to achieve the acquisition of 100% equity interest. Thus far, we have not come across a triangular merger.

After the latest amendments to the Company Act took effect in November 2018, shareholders holding over 50% of shares are permitted to call a shareholders' meeting, without needing the board to call such meeting. This allows insurgent shareholders to replace the incumbent board as soon as the insurgent shareholders acquire a majority stake. This is worth noting for hostile takeovers.

The competent authority is expected to amend the current M&A Act in response to the Constitutional Court's concerns

On the other hand, the tender offer rules were amended following the XPEC Incident. According to the amended Regulations Governing Tender Offers for Securities of Public Companies, a tender offeror is required to provide documents to prove its ability to settle the consideration stated in the tender offer. This means that a tender offeror may be required to have its acquisition fund in place at a much earlier stage of the tender offer.

In November 2018, the Justices of the Constitutional Court granted a minority shareholder in a cash-out merger in 2007 an appraisal right in Interpretation No. 770, on the basis that the then effective M&A Act failed to afford sufficient protection in a cash-out merger and was therefore unconstitutional. The Justices of the Constitutional Court further opined that the current M&A Act (in effect since 2015) is also flawed in terms of shareholder protection, including with regards to disclosure requirements. Public comment on this Constitutional Court interpretation is that the validity of the current M&A Act is not immediately affected. On the other hand, the competent authority is expected to amend the current M&A Act in response to the Constitutional Court's concerns.

Regulations under discussion

There are a few developments worth keeping an eye on. First, with regard to the media industry, the government and the private sector are debating the loosening of restrictions on government and political

party investment into companies operating TV channels or TV networks. Currently, the government and political parties are prohibited from investing in any TV channels or networks. As a result, many listed companies are prohibited from investing in such companies, given that government-operated-funds would often invest in listed companies by acquiring shares from the local market.

The government has also proposed to amend the *Statute for Investment by Foreign Nationals*, which governs foreign investments, by replacing the current prior approval system with a post-closing notification system for deals under a certain size. The proposed amendment also aims to shorten the foreign investment review process. By and large, the proposed amendment is expected to be friendlier to cross-border M&A deals.

Meanwhile, PRC companies and PRC-invested companies have been eager to invest in businesses in Taiwan, such as semiconductor companies or online gaming companies. The current administration's position in this regard will determine whether and how such M&A transactions could be structured.

MARKET NORMS

Information disclosure and insider trading are important and sensitive areas for public companies. However, local management sometimes underestimates their importance and fails to make the proper disclosures. In many instances large public M&A transactions crossed red lines as regards insider trading and quite a few criminal investigations have been launched. There have been many attempts to manipulate the stock prices of listed companies in order to reap improper gains.

In many instances large public M&A transactions crossed red lines as regards insider trading

With regard to the XPEC incident, the chairman and certain management personnel of XPEC were accused of assisting others to drive up the stock prices of XPEC via several avenues, including a proposed tender offer, so that they could gain greater profits from selling XPEC's shares on the market during the tender offer period. The prosecutors asserted that the accused manipulated a planned takeover bid by a Japanese firm allegedly controlled by a PRC owner. The court of first instance (Taipei District Court) found the XPEC chairman guilty of fraud and sentenced him to 18 years' imprisonment with a criminal fine of $3.4 million ($100 million NTD). In the decision rendered by the court of second instance (Taiwan High Court), the XPEC chairman was sentenced to 12 years' imprisonment with the same amount of criminal fine. The case is still appealable and revocable.

Frequently overlooked areas

Public companies need to pay more attention to information disclosure when they plan M&A transactions. This includes understanding what information should be disclosed and the proper timing for disclosing certain pieces of information to the market. Most important of all, the insiders of a public company should not trade any shares in the public company before proper information disclosure. Professional advice should be sought regarding this issue.

In Taiwan, M&A transactions are often subject to regulatory approvals, such as foreign investment approvals or PRC investment approvals. For those industries that are required to hold a special licence/permit, such as banking, securities firms, insurance companies, and so on, approval from the competent authority, such as the FSC, needs to be obtained in advance. Meanwhile, any M&A transaction triggering the pre-closing antitrust filing threshold needs to obtain antitrust clearance before closing.

Given all these requirements, whether and how regulatory approvals can be smoothly obtained are issues critical to the completion of an M&A transaction in Taiwan. As such, it is advisable that the investors intending to conduct an M&A transaction in Taiwan to seek professional assistance in advance, in order to better understand the regulatory requirements and application process.

PUBLIC M&A

Given that under the Taiwan Company Act material decisions require the approval from shareholders holding two-thirds of the voting shares of a company, in order to gain an absolute control of a public company an acquirer should aim to acquire or control at least 67% of the shares. In practice, given that not all of the shareholders attend shareholder meetings, to control the management or operation of a listed company, it is sometimes sufficient for one investor to control 30% to 40% of the voting rights in a listed company. In sum, this would largely depend on the shareholding structure of a particular listed company.

Conditions for a public takeover

In local practice, the conditions of a tender offer usually include the minimum and maximum number of shares that the shareholders of the target company agree to tender during the tender offer period; the tender offeror obtaining the required government approvals, if any (such as antitrust clearance and foreign investment approval, for example); and no occurrence of any material adverse event (subject to the approval of the FSC). After the XPEC case, the FSC amended the relevant tender offer regulations in 2016 to increase scrutiny and enhance transparency in tender offers. Specifically, under the amended tender offer regulations, a tender offeror has to prove its ability to perform the obligation to pay the tender offer consideration. Such proof can be in the form of either a bank guarantee, a report from an independent financial adviser or a certified public accountant (CPA) attesting to the offeror's ability to pay the tender offer consideration.

Break fees

In terms of tender offers and other types of M&A transactions between public companies, we have rarely seen break fee arrangements.

PRIVATE M&A

Large private M&A transactions often adopt a completion accounts mechanism under which the purchase price is adjusted in accordance with the post-closing audit of the financial status of the target company, as at closing date. For transactions with a smaller value, it is more common for the parties to adopt the locked-box mechanism. Earn-out mechanisms and escrow arrangements are commonly seen in private M&A transactions.

Major shareholders would usually not consider a Taiwanese IPO as an exit priority

Warranty and indemnity (W&I) insurance seems to be a better way for the seller and buyer to allocate their respective risks in an M&A transaction. We have seen the concept being discussed in local M&A transactions, though the actual implementation of such a mechanism is rare.

Conditions for a private takeover

The customary closing conditions attached to a private takeover offer usually include, among others, that the seller's representations and warranties remain true and correct; that the required government approval (if any) has been obtained; that the required third party consent (if any) has been obtained; that no material adverse event has occurred; that no action or government order is seeking to deter or enjoin the proposed M&A transaction; and that other commercial arrangements required by the parties have been completed or achieved (this would usually be structured based on the due diligence findings).

Foreign governing law

In the event that any party in a private M&A transaction belongs to a foreign corporate group, such a party would normally require that the transaction documents be governed by the law of the foreign country where the headquarters of the foreign corporate group is located. Any dispute arising from the transaction documents will then be resolved via the court of a foreign jurisdiction or an arbitration proceeding conducted outside of Taiwan. Local parties would normally accept such arrangements.

The exit environment

The IPO market in Taiwan is generally perceived as serving the purpose of fund-raising rather than exiting, due to lock-up requirements, minimum shareholding requirements, legal requirements and limitations on selling shares that are applied to major shareholders, directors and supervisors. For the major shareholders of a public company that wish to sell their shares to a potential buyer, a mandatory tender offer may be triggered if more than 20% of the shareholding will be transferred within 50 days. Consequently, major shareholders' exit in the open market may be treated as a trade sale.

In recent years, due to the low PE ratio of the Taiwan stock market and the strong performance of other stock exchanges in Asia (such as Shanghai Stock Exchange), the Taiwanese IPO market has been slow. This is another reason why major shareholders would usually not consider a Taiwanese IPO as an exit priority.

On the other hand, trade sales or sales to financial sponsors have always been a major exit route. Other than highly regulated industries (such as media or cable TV) or acquisitions involving PRC funding, there should be no substantial hurdle for an exit, albeit that the regulatory approval process may sometimes take a long time. As for highly regulated industries and investments involving PRC funding, the Taiwanese government has been criticised for the prolonged regulatory approval process and lack of transparency in its decision-making process.

OUTLOOK

In light of government policy and global trends, as well as a national movement in favour of a reduction in nuclear energy generation, it is expected that M&A transactions will continue to thrive in the renewable energy sector, despite the recent setbacks created by a decrease in the applicable tariff rate for the sale of wind power.

Meanwhile, considering the current government's conservative attitude toward PRC investments, and due to the sensitivity of the cross-strait relationship, we do not expect major transactions involving PRC funding to take place in Taiwan. However, it is anticipated that there will be more inquiries regarding so-called VIE structures or other alternative structures to achieve collaboration between PRC investors and Taiwanese companies.

Legal professionals will need to pay more attention to planning cross-border M&A activity in terms of the coordination of legal requirements in different jurisdictions and, more importantly, whether and how the various required government approvals can be obtained.