M&A Litigation 2019

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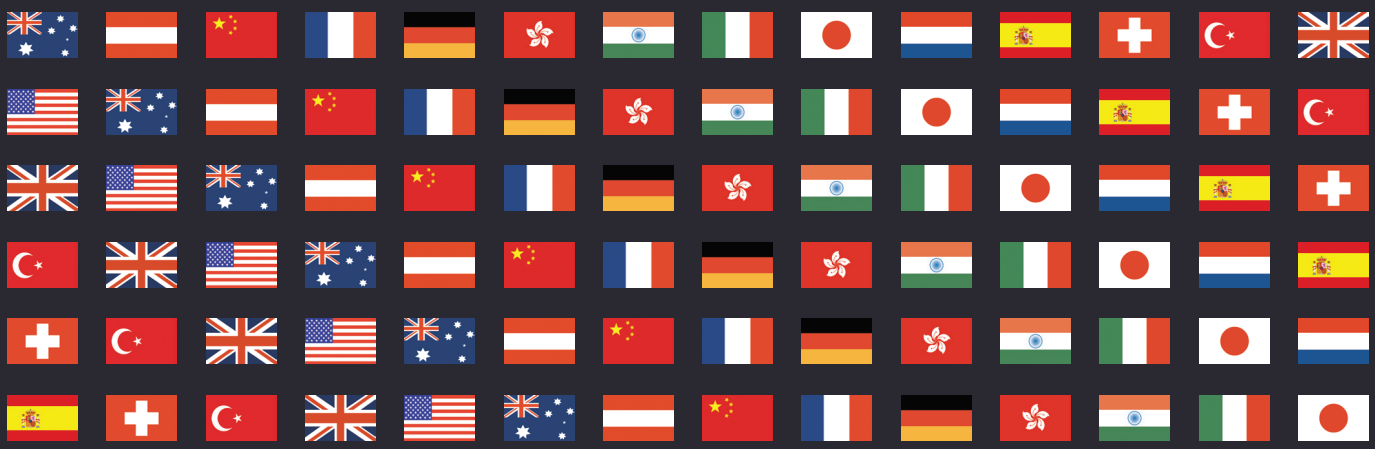

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Publisher
Tom Barnes
tom.barnes@lbresearch.com

Subscriptions
Claire Bagnall
claire.bagnall@lbresearch.com

Senior business development managers
Adam Sargent
adam.sargent@gettingthedealthrough.com

Dan White
dan.white@gettingthedealthrough.com

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Law Business Research Ltd
87 Lancaster Road
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Fax: +44 20 7229 6910

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Contributing editors
William M Regan, Jon M Talotta and Ryan M Philp
Hogan Lovells US LLP

Lexology Getting The Deal Through is delighted to publish the second edition of *M&A Litigation*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Australia, Austria and China.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, William M Regan, Jon M Talotta and Ryan M Philp of Hogan Lovells US LLP, for their continued assistance with this volume.

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Getting The Deal Through

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Contents

Introduction

William M Regan, Jon M Talotta and Ryan M Philp
Hogan Lovells US LLP

M&A transactions typically are transformational corporate events. From comparatively small private company transactions involving tens of millions of US dollars, to the largest multinational public company deals worth more than US$100 billion, the purchase or sale of any company involves significant risks and many uncertainties. M&A transactions impact the participants – directors, officers, employees, stockholders, creditors and customers – at every level of the corporate enterprise. And even the most strategic and well-planned M&A transactions sometimes fail to deliver the economic benefits that the parties anticipated at signing. These factors individually and collectively make M&A transactions ripe for litigation.

M&A litigation also raises many important policy issues, ranging from the appropriate role of corporate directors and stockholders both in making business decisions and in pursuing internal corporate misconduct, to the enforceability of contract provisions allocating various risks in connection with private company deals. The individual chapters that follow this introduction summarise how key jurisdictions around the world address these policy issues, and the extent to which they permit, encourage or limit M&A litigation. A survey of these chapters reveals a number of significant similarities, but also a number of important differences.

Common themes in global M&A litigation

Across common law and code law countries, there are a number of striking similarities with respect to how different jurisdictions address M&A litigation issues. For example, nearly every country addressed in this book expressly or impliedly embraces some form of what in the US is called the 'business judgement rule'. Whether characterised as a formal legal presumption or simply the inherent reluctance of judges to interfere with discretionary business decisions, jurisdictions around the world show a strong tendency to protect or defer to corporate decision-making in the M&A context where the board acts in good faith, on an informed basis and without conflicts of interest.

Similarly, nearly every jurisdiction requires that corporate actors in the M&A context comply with some variation of the duty of care and the duty of loyalty. To uphold a challenged M&A decision, courts broadly require that directors and management make decisions on a fully informed basis, acting with the care of a reasonably prudent person under the applicable facts and circumstances. Jurisdictions consistently require that corporate representatives disclose or avoid conflicts of interest, such that M&A decisions are made in good faith in the best interests of the corporate enterprise, and not in the personal interests of any individual director or officer.

Another commonality across jurisdictions concerns the impact of a stockholder vote. After a board has approved an M&A transaction, separate approval by the stockholders is often required before the transaction can close. In most jurisdictions, where the stockholder vote is made on a fully informed basis, subsequent claims challenging the deal or the directors' conduct in connection with the deal typically will be barred. This may be under a theory that the stockholder vote 'ratified' the board's decision, that the vote 'cleansed' the transaction of any fiduciary duty issues or that stockholders are 'estopped' from challenging a transaction approved by a majority of investors.

One final recurring theme is that nearly every jurisdiction applies additional scrutiny with respect to responsive or defensive measures taken by a board in response to unsolicited takeover proposals. Some jurisdictions impose heightened judicial scrutiny on such measures, while others require separate stockholder or regulatory approval. But in all cases, jurisdictions recognise the increased risks and potential conflicts when a board acts in response to an unsolicited offer.

Notable differences in M&A litigation across jurisdictions

There also are a number of stark differences in M&A litigation across jurisdictions. For example, outside of the United States, few jurisdictions allow individual stockholders to pursue broad class or collective actions on behalf of all similarly situated investors, and, in particular, few jurisdictions permit class actions that require investors to affirmatively 'opt out' to avoid being bound by a judgment. Note, however, that certain European jurisdictions, including the UK and the Netherlands, have seen the emergence of collective action rules and procedures that apply in certain types of cases and that have similar features to class actions. The 'internationalisation' of US-style class actions may continue in the coming years.

Jurisdictions also vary significantly on the extent to which they permit individual investors to pursue 'derivative' actions to recover damages incurred by the corporation (some allow broad derivative rights, some do not recognise the procedure at all, and still others provide for minimum ownership requirements or court approval before an investor will be permitted to proceed).

Similarly, few jurisdictions permit stockholders to take broad pretrial discovery in M&A litigation, although most recognise some form of a books-and-records inspection right. The majority of courts also limit the ability of corporate defendants to resolve M&A litigation through early dispositive motion practice.

Jurisdictions also follow significantly varying approaches with respect to whether a corporation may limit liability for directors involved in M&A transactions through exculpatory by-law or corporate charter provisions. Some jurisdictions broadly allow such provisions; others find them void as against public policy; and others permit them for certain types of claims (eg, claims sounding in ordinary negligence or claims by outside third parties).

One final notable difference is the extent to which jurisdictions permit corporations to require stockholders to bring M&A litigation in particular forums. Certain jurisdictions permit corporations to mandate that stockholders bring M&A litigation in particular courts or even in arbitration, while others apply their general jurisdiction and venue rules.

Conclusion

Public company M&A litigation is most common in the United States and certain other countries discussed in this book. This appears to be

because of class action and discovery mechanisms that permit an individual investor to pursue claims on behalf of other similarly situated investors. It is important to note, however, that US public company M&A litigation is currently undergoing significant changes. Certain leading courts have changed the law to afford greater deference to arms-length transactions approved by a stockholder vote. These changes appear to have brought US law more in line with that of other jurisdictions permitting collective actions. Following these decisions, there has been a slight reduction in the overall number of suits filed, along with changes to the types of claims being asserted and the venues where cases are being filed. The ultimate impact of these recent changes remains to be seen, however, both within and outside the United States.

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Hong Kong

Chris Dobby and Grace Zhu
Hogan Lovells International LLP

TYPES OF SHAREHOLDERS' CLAIMS

Main claims

1 | Identify the main claims shareholders in your jurisdiction may assert against corporations, officers and directors in connection with M&A transactions.

The main types of claims shareholders may assert against companies, officers and directors in connection with M&A transactions include:

- statutory (section 725(1)(b) or (2) of the Companies Ordinance) and common law unfair prejudice claims;
- statutory claims for breach of fiduciary duty by a director (section 728(4)(b) of the Companies Ordinance); and
- common law claims against directors for acting in excess of their powers or acting unfairly to the members.

Shareholders may have claims in their own names (personal actions) or in the name of the company (derivative actions). Section 732 of the Companies Ordinance allows a member of a company, with leave of the court, to bring derivative proceedings on behalf of the company in respect of any 'misconduct' committed against the company.

Other common causes of action vary from common law claims for breach of contract (including in relation to rights set out in the company's articles of association, which may also be pursued under section 728(4)(c) of the Companies Ordinance); and claims against third parties for aiding and abetting a default of the Companies Ordinance, or breach of a fiduciary duty and breach of a fiduciary duty by a party other than a director of the company (section 728(4)(a) of the Companies Ordinance).

Requirements for successful claims

2 | For each of the most common claims, what must shareholders in your jurisdiction show to bring a successful suit?

For unfair prejudice actions, a shareholder must satisfy the court that the company's affairs are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or of one or more members; or an actual or proposed act or omission of the company (including one done or made on behalf of the company) is or would be so prejudicial.

For breach of fiduciary duty actions, a shareholder must show that a director has failed to act honestly, in good faith and in the best interests of the company as a whole; or a director has failed to exercise his or her powers for the proper purposes for which those powers have been conferred on him or her.

The directors of a company must exercise reasonable care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions of the director, and in relation to the company (section 465(2)(a) of the Companies Ordinance); or the general knowledge, skill and experience that the director has (section 465(2)(b) of the Companies Ordinance).

A registered shareholder of the company or a shareholder of an associated company (ie, a subsidiary or holding company of the first company) may bring a derivative claim under section 732 of the Companies Ordinance if it can satisfy the court that:

- on the face of the application, it appears to be in the company's interests that leave should be granted;
- there is a serious question to be tried;
- the company has not itself brought the proceedings; and
- the shareholder has served a written notice on the company of his or her intention to apply for leave.

If leave of the court is obtained, the shareholder must prove on the balance of probability the company's entitlement to the relief sought at the full trial.

Publicly traded or privately held corporations

3 | Do the types of claims that shareholders can bring differ depending on whether the corporations involved in the M&A transaction are publicly traded or privately held?

The basic principles for a shareholder to bring a claim against directors, officers or third parties in M&A transactions between privately held companies and publicly traded companies are generally the same. However, there might be additional regulations on public companies (particularly publicly listed companies).

In Hong Kong, the Companies Ordinance defines that a company is a 'private company' if its articles of association restrict the right to transfer shares, limit the number of its members to no more than 50, and prohibit any invitation to the public to subscribe for shares in, or debentures of, the company. The term 'public companies' is defined in the Companies Ordinance as companies other than private companies and companies limited by guarantee.

Public companies listed in Hong Kong are subject to:

- the Securities and Futures Ordinance (SFO);
- the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited or the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (Listing Rules); and
- the Codes on Takeovers and Mergers and Share Buy-Backs (Takeovers Code).

Publicly listed companies have various disclosure and reporting obligations under part XV of the SFO, the Listing Rules and the Takeovers Code to ensure a fair market and to protect investors' interests.

The Securities and Futures Commission of Hong Kong can bring a civil action before the Market Misconduct Tribunal (MMT) for suspected market misconduct or other infringements of the SFO.

Shareholders also have separate statutory rights of action under the SFO through the civil courts (section 281 of the SFO) if the shareholders have suffered financial loss caused by any form of market misconduct. The MMT's findings in relation to market misconduct will be admissible in evidence in a private civil action (section 281 (7) of the SFO). For a shareholder's civil claim to be successful, the court has to be satisfied that it is 'fair, just and reasonable' that compensation should be paid in the circumstances of the case (section 281 (2) of the SFO).

For publicly traded companies, the grounds for shareholders' claims for unfairly prejudicial conduct in an M&A transaction are limited to conduct that is in breach of their legal or equitable rights, or universal expectations of shareholders. However, for privately held companies, in addition to the legal, equitable and universal expectation of shareholders, personal expectations arising from personal relationships or dealings between parties with mutual trust and confidence are generally protected under the Companies Ordinance.

Form of transaction

4 Do the types of claims that shareholders can bring differ depending on the form of the transaction?

No.

Negotiated or hostile transaction

5 Do the types of claims differ depending on whether the transaction involves a negotiated transaction versus a hostile or unsolicited offer?

No. However, in the case of a hostile or unsolicited takeover offer, under the Companies Ordinance, minority shareholders who do not accept the offer may under certain circumstances have the right to be bought out by the purchaser.

Party suffering loss

6 Do the types of claims differ depending on whether the loss is suffered by the corporation or by the shareholder?

Yes.

If the loss is suffered by a shareholder, the types of claims available would mostly be unfair prejudice claims or contractual claims for breach of the company's constitutional documents.

Claims for losses suffered by the company itself may be brought by a shareholder in the form of derivative actions, for example, against the directors for breach of their fiduciary duties.

COLLECTIVE AND DERIVATION LITIGATION

Class or collective actions

7 Where a loss is suffered directly by individual shareholders in connection with M&A transactions, may they pursue claims on behalf of other similarly situated shareholders?

There is no class or collective action regime in Hong Kong. The only multiparty proceedings regime is the procedure for representative proceedings provided under order 15, rule 12 of the Rules of the High Court, which allows one or more persons to start or continue proceedings as representatives of other persons who have the 'same interest' in the proceedings. However, this mechanism has limited application due to the strict interpretation of the 'same interest' requirement in the Hong Kong Court of Appeal case, *Markt & Co Ltd v Knight Steamship Co Ltd* (*Markt & Knight*). In particular, the plaintiffs must prove the the existence of the same contract between all plaintiff class members and the defendant; the same defence (if any) pleaded by the defendant against all the plaintiff class members; and the same relief claimed by the plaintiff class members.

Although some piecemeal judicial initiatives have been taken to relax such requirements, *Markt & Knight* has never been expressly overruled, and it is still the leading case in Hong Kong.

It is also worth noting that a shareholder, when making an unfair prejudice petition, can join other shareholders as respondents.

Derivative litigation

8 Where a loss is suffered by the corporation in connection with an M&A transaction, can shareholders bring derivative litigation on behalf or in the name of the corporation?

Yes.

Shareholders of a company or of an associated company may bring derivative actions under section 732 of the Companies Ordinance if there has been 'misconduct' committed against the company. 'Misconduct' is widely defined under the Companies Ordinance as fraud, negligence, breach of duty or default in compliance with any ordinance or rule of law.

In addition, common law derivative actions can be brought by shareholders where a loss is suffered by the company under circumstances where the company has engaged in conduct that is ultra vires or illegal; or parties that are in control of the company commit a fraud on the company.

INTERIM RELIEF AND EARLY DISMISSAL

Injunctive or other interim relief

9 What are the bases for a court to award injunctive or other interim relief to prevent the closing of an M&A transaction? May courts in your jurisdiction enjoin M&A transactions or modify deal terms?

The court has a wide discretion under the Companies Ordinance and the Companies (Winding Up and Miscellaneous Provisions) Ordinance to award injunctive or other interim relief on such terms as the court deems appropriate. This extends to M&A transactions.

For example, sections 728 to 729 permit certain persons, including shareholders of a company, to seek an injunction to restrain breaches of the Companies Ordinance, breaches of fiduciary duties by directors or breaches of the company's articles.

The court also has a general power under section 21L of the High Court Ordinance to grant an injunction in all cases where it is 'just and convenient' to do so.

Early dismissal of shareholder complaint

10 May defendants seek early dismissal of a shareholder complaint prior to disclosure or discovery?

Yes. There is no distinction between M&A litigation and the usual situations in which summary judgment or strike out may be awarded, albeit a personal shareholder claim could be struck out where the loss being claimed has been suffered by the company rather than the individual shareholder (where the proper procedure would be a derivative action), and vice versa.

Other common grounds for strike out of a shareholder's claim include that the pleading discloses no reasonable cause of action, is scandalous, frivolous or vexatious, or is an abuse of process.

In addition, under section 736 of the Companies Ordinance, in circumstances where statutory derivative proceedings are on foot and the same shareholder or shareholders initiate a common law derivative action in respect of the same cause or matter, the court has the power

to strike out part or the whole of the pleading in relation to the common law claim or to award summary judgment dismissing it.

ADVISERS AND COUNTERPARTIES

Claims against third-party advisers

11 Can shareholders bring claims against third-party advisers that assist in M&A transactions?

Yes, shareholders can bring derivative actions, on behalf of the company, against third-party advisers that assist in M&A transactions if the third-party advisers have committed a wrong against the company.

Claims against counterparties

12 Can shareholders in one of the parties bring claims against the counterparties to M&A transactions?

Yes. For example, section 728 of the Companies Ordinance permits claims against parties other than directors in circumstances where:

- a person has engaged in, is engaging in or is proposing to engage in conduct that constituted, constitutes or would constitute:
  - a contravention of the Companies Ordinance;
  - a default relating to a contravention of the Companies Ordinance; or
  - a breach specified in subsection (4) of section 728 of the Companies Ordinance; or
- a person has refused or failed, is refusing or failing, or is proposing to refuse or fail, to do an act or thing that the person is required by the Companies Ordinance to do.

A default for the purposes of this section of the Companies Ordinance is defined as:

- an attempt to contravene the Companies Ordinance;
- aiding, abetting, counselling or procuring another person to contravene the Companies Ordinance;
- inducing or attempting to induce, whether by threats, promises or otherwise, another person to contravene the Companies Ordinance;
- being in any way, directly or indirectly, knowingly concerned in or a party to a contravention of the Companies Ordinance by another person; or
- conspiring with others to contravene the Companies Ordinance.

LIMITATIONS ON CLAIMS

Limitations of liability in corporation's constitution documents

13 What impact do the corporation's constituting documents have on the extent board members or executives can be held liable in connection with M&A transactions?

It depends on the terms of the relevant constitutional documents. Various versions of model articles are set out in the Companies (Model Articles) Notice.

Under section 468 of the Companies Ordinance, any provision, whether contained in the articles of a company, or in any contract with a company or otherwise, for exempting a director of the company from any liability to the company or an associated company that by virtue of any rule of law would otherwise attach to him or her in respect of any negligence, default, breach of duty or breach of trust of which he or she may be guilty, is void.

Statutory or regulatory limitations on claims

14 Are there any statutory or regulatory provisions in your jurisdiction that limit shareholders' ability to bring claims against directors and officers in connection with M&A transactions?

Not specifically, but under the Companies Ordinance, the court may refuse to grant a shareholder leave to bring a derivative claim or to intervene if it is satisfied that:

- in the case of an application for leave to bring proceedings under section 732(1) or (2), the member has, in the exercise of any common law right, brought proceedings on behalf of the company in respect of the same cause or matter; or
- in the case of an application for leave to intervene in proceedings under section 732(3), the member has, in the exercise of any common law right, intervened in the proceedings in question to which the company is a party.

Common law limitations on claims

15 Are there common law rules that impair shareholders' ability to bring claims against board members or executives in connection with M&A transactions?

Yes. The rules laid down in the English case of *Foss v Harbottle* apply in Hong Kong, which impose restrictions on the ability of shareholders to bring claims against board members or executives who committed a wrong to the company. The rules include the proper plaintiff principle and the irregularity principle.

Under the proper plaintiff principle, where directors have breached their duties owed to the company or any person has committed a wrong to the company, the proper plaintiff to bring an action against the wrongdoer is the company save in circumstances where the criteria to bring a derivative action are satisfied.

Under the irregularity principle, shareholders cannot sue to complain of a mere irregularity that can be cured by a vote of the company in a general meeting and where the intention of the majority shareholders is clear.

Apart from the above principles, if shareholders bring a common law derivative claim, the shareholders are also subject to certain restrictions as follows:

- the shareholders must show they have a claim for illegal conduct or acts that are ultra vires, or that there has been a fraud on the company or, less commonly, that it is in the interests of justice;
- only current registered shareholders can bring an action;
- the shareholders must not have engaged in inequitable or unjust conduct; and
- where the majority shareholders acting independently of the wrongdoers and without collateral purpose ratify the wrongdoers' actions, such ratification can effectively prevent a derivative action being brought.

There is, at present, no statutory equivalent in Hong Kong to the US-style 'business judgement rule'.

STANDARD OF LIABILITY

General standard

16 What is the standard for determining whether a board member or executive may be held liable to shareholders in connection with an M&A transaction?

For a director or an executive to be held liable to shareholders in connection with an M&A transaction, the shareholders must prove that on the

balance of probabilities, the director's or executive's conduct infringes the shareholders' personal rights. Shareholders' personal rights can arise pursuant to the company's constitution, common law, a contract or statute. In cases where the conduct of the director or the executive infringes both the company's rights and the shareholders' personal rights, the shareholders' loss should be separate and distinct and not properly regarded as being reflective of the company's loss. In determining whether the shareholders' loss is reflective of the company's loss, the test is whether the loss would be made good if the company was able to recover for its own loss.

If a shareholder wishes to seek remedies under an unfair prejudice action (section 724 of the Companies Ordinance), it must prove that the company's affairs are managed by the wrongdoer in a way that is unfairly prejudicial to the shareholders. The concept of the 'company's affairs' is given wide interpretation, and includes contracts, assets, goodwill, profits and loss, business or trade matters, capital structure, dividend policy, voting rights, and other external activities and internal management.

Type of transaction

17 | Does the standard vary depending on the type of transaction at issue?

No. However, infringements of the shareholders' personal rights that can be caused by a director or executive differ based on the specific circumstances of the transaction.

Type of consideration

18 | Does the standard vary depending on the type of consideration being paid to the seller's shareholders?

No.

Potential conflicts of interest

19 | Does the standard vary if one or more directors or officers have potential conflicts of interest in connection with an M&A transaction?

No. A director has a duty in common law to avoid conflicts between his or her personal interests and those of the company. Section 536 of the Companies Ordinance states that if a director of a company has a material interest in a transaction, arrangement or contract, or a proposed transaction, arrangement or contract, with the company, that is significant in relation to the company's business, the director must declare the nature and extent of his or her interest to the other directors.

Controlling shareholders

20 | Does the standard vary if a controlling shareholder is a party to the transaction or is receiving consideration in connection with the transaction that is not shared rateably with all shareholders?

No. There is no equivalent in Hong Kong to the US-style 'entire fairness rule'.

INDEMNITIES

Legal restrictions on indemnities

21 | Does your jurisdiction impose legal restrictions on a company's ability to indemnify, or advance the legal fees of, its officers and directors named as defendants?

Yes. Under section 468 of the Companies Ordinance, if a provision in a company's constitutional documents purports to exempt a director of the company from any liability that would otherwise attach to the director in connection with any negligence, default, breach of duty or breach of trust in relation to the company, the provision is void.

In addition, if, by a provision of a company's constitutional documents the company directly or indirectly provides an indemnity for a director of the company, or a director of an associated company, against any liability attaching to the director in connection with any negligence, default, breach of duty or breach of trust in relation to the company or associated company (as the case may be), the provision is void.

Section 469 of the Companies Ordinance permits a company to indemnify a director against liability incurred by the director to a third party if specified conditions are met. Certain liabilities and costs must not be covered by the indemnity, such as:

- criminal fines;
- penalties imposed by regulatory bodies;
- the defence costs of criminal proceedings where the director is found guilty; and
- the defence costs of civil proceedings brought against the director by or on behalf of the company or an associated company in which the judgment is given against the director.

M&A CLAUSES AND TERMS

Challenges to particular terms

22 | Can shareholders challenge particular clauses or terms in M&A transaction documents?

Assuming the M&A transaction documents are governed by Hong Kong law and subject to the exclusive jurisdiction of the Hong Kong court, shareholders can challenge particular clauses in the signed transaction documents if the shareholders believe that the execution of the particular clauses is, for example, unfairly prejudicial to the shareholders.

In privately negotiated M&A transactions in Hong Kong, it is not common to see a shareholder challenge particular clauses that, for example, preclude third-party bidders.

PRE-LITIGATION TOOLS AND PROCEDURE IN M&A LITIGATION

Shareholder vote

23 | What impact does a shareholder vote have on M&A litigation in your jurisdiction?

Under the Companies Ordinance, a special resolution (a resolution that is passed by a majority of at least 75 per cent of the shareholders who attend and vote, in person or by proxy, (section 564(1)) is required for important matters such as, but not limited to:

- alteration of the articles of association (section 88(2)(3)of the Companies Ordinance);
- change of the company's name (section 107(1)of the Companies Ordinance);
- reduction of a company's share capital (section 215(1)of the Companies Ordinance);
- an unlisted company buying back its shares (section 244(1)(2) of the Companies Ordinance); and

- pay out of a company's capital in respect of the redemption or buy-back of shares (section 258(1)of the Companies Ordinance).

Furthermore, under section 473 of the Companies Ordinance, shareholders may vote to ratify conduct by a director involving negligence, default, breach of duty or breach of trust in relation to the company.

However, pursuant to section 734 of the Companies Ordinance, this does not prevent a shareholder bringing a derivative action in relation to the ratified conduct, and when considering the derivative action, the court will take into account:

- whether the members were acting for proper purposes, having regard to the company's interests, when they approved or ratified the conduct;
- to what extent those members were connected with the conduct when they approved or ratified the conduct; and
- how well informed about the conduct those members were when they decided whether to approve or ratify the conduct.

Insurance

24 | What role does directors' and officers' insurance play in shareholder litigation arising from M&A transactions?

Under section 468(4) of the Companies Ordinance, a company is permitted to take out insurance for its directors for:

- any liability to any person attaching to the director in connection with any negligence, default, breach of duty or breach of trust (except for fraud) in relation to the company or associated company (as the case may be); or
- any liability incurred by the director in defending any proceedings (whether civil or criminal) taken against the director for any negligence, default, breach of duty or breach of trust (including fraud) in relation to the company or associated company (as the case may be).

Burden of proof

25 | Who has the burden of proof in an M&A litigation – the shareholders or the board members and officers? Does the burden ever shift?

It depends on who brings the litigation and what remedy is sought. If directors commence the litigation on behalf of the company, the directors have the burden to prove the company's claim. If the shareholders bring a derivative action on behalf of the company or bring a claim for infringement of their personal rights, the shareholders have the burden of proof.

Pre-litigation tools

26 | Are there pre-litigation tools that enable shareholders to investigate potential claims against board members or executives?

Yes. For example, under section 740 of the Companies Ordinance, upon application to the court by members representing at least 2.5 per cent of the voting rights of all the members who are entitled to vote at the company's general meeting or at least five members of the company, the court may make an order to authorise a person to inspect any record or document of the company if the court satisfies that the application is made in good faith and the inspection is for a proper purpose.

However, according to section 741 of the Companies Ordinance, the authorised person is not allowed to disclose the information obtained to anyone that is not the applicant, without the company's prior written consent, unless stated otherwise by section 741 (3) of the Companies Ordinance (eg, for the purpose of criminal proceedings or for any other requirement under the law).

Under section 41 of the High Court Ordinance and Order 24, Rule 7A of the Rules of the High Court, a shareholder may apply for a pre-action disclosure order against board members or executives of the company, if the shareholder can prove that: (i) the shareholder is likely to be a party to subsequent proceedings; (ii) the person against whom the order is sought is likely to be a party to subsequent proceedings; and (iii) such person is likely to have or to have had in his or her possession, custody or power any relevant documents.

Forum

27 | Are there jurisdictional or other rules limiting where shareholders can bring M&A litigation?

No.

Expedited proceedings and discovery

28 | Does your jurisdiction permit expedited proceedings and discovery in M&A litigation? What are the most common discovery issues that arise?

A court may expedite proceedings to resolve certain issues quickly, and particularly in the context where an injunction is granted to delay closing, in the same way as it would with any type of civil claim.

Common discovery issues arise in relation to access to the transactional documents and due diligence as to the parties to the transactions and relevant third parties.

DAMAGES AND SETTLEMENTS

Damages

29 | How are damages calculated in M&A litigation in your jurisdiction?

There are no special rules in Hong Kong regarding calculation of damages in M&A litigation. The normal rules as to the calculation of damages apply, including the principles of remoteness.

However, there are various mechanisms, in relation to post-closing claims, for quantifying adjustments to the purchase price based on value, such as discounted cash flow or net asset value.

Settlements

30 | What are the special issues in your jurisdiction with respect to settling shareholder M&A litigation?

There are no special issues in Hong Kong with respect to settling shareholder M&A litigation.

THIRD PARTIES

Third parties preventing transactions

31 | Can third parties bring litigation to break up or stop agreed M&A transactions prior to closing?

Third parties may seek injunctive relief to break up or stop agreed M&A transactions prior to closing if they have an underlying cause of action either in tort or contract, or pursuant to statute.

However, litigation without a cause of action issued for the sole purpose of creating pressure would be at risk of being struck out for abuse of process.

Third parties supporting transactions

32 Can third parties in your jurisdiction use litigation to force or pressure corporations to enter into M&A transactions?

Specific performance is an available remedy in Hong Kong and can be used to compel parties to perform their obligations, including proceeding with a transaction.

However, as above, litigation without a cause of action issued for the sole purpose of creating pressure would be at risk of being struck out for abuse of process.

UNSOLICITED OR UNWANTED PROPOSALS

Directors' duties

33 What are the duties and responsibilities of directors in your jurisdiction when the corporation receives an unsolicited or unwanted proposal to enter into an M&A transaction?

In Hong Kong, directors' fiduciary duties mainly arise from common law, which include the following duties:

- to act in good faith in the interests of the company;
- to exercise powers for proper purposes;
- to avoid conflicts of interests;
- not to make secret profits; and
- not to misappropriate company assets.

In addition, the directors also have a statutory duty to exercise due care, skill and diligence under section 465 of the Companies Ordinance.

Therefore, when directors consider an unsolicited or unwanted proposal, the directors must comply with their fiduciary duties.

There are situations where directors attempt to defeat takeover offers by entering into agreements that are triggered upon a takeover offer and that might make it prohibitively expensive or otherwise unattractive for an offeror to proceed (the 'poison pill' arrangement), or an agreement involving the disposal of the company's major assets (the 'sale of the crown jewels'). In such case, whether the directors have breached their fiduciary duties depends on the specific circumstances. If, for example, it is clear that the directors' purpose of refusing an unsolicited M&A proposal is simply to preserve their positions in the company, then it may amount to a breach of duty.

For public companies, the directors must also comply with the Takeovers Code. Under general principle 9, directors of a target company cannot, without general meeting approval, take action in relation to the affairs of the company that could effectively result in any bona fide offer being frustrated or shareholders being denied a chance to decide its merit. However, for private companies, as the articles must impose restrictions on the right of shareholders to transfer shares, the directors are justified to ensure that the identities of shareholders are consistent with the company's interests. As such, the directors of private companies may be given more latitude in determining whether an M&A proposal should be carried forward or defeated.

COUNTERPARTIES' CLAIMS

Common types of claim

34 Shareholders aside, what are the most common types of claims asserted by and against counterparties to an M&A transaction?

The claims differ depending on the stage of the M&A transaction.

Before the M&A agreement has been signed, disputes that concern the behaviour of contractual parties could include breaches of pre-signing confidentiality or exclusivity provisions; or breaches of letters of intention (LOIs) (these often involve the issue of whether and to what extent the LOI is binding, and if the LOI is not binding, whether there are any pre-contractual obligations deriving from the LOI).

After signing the M&A agreement, most of the claims are based on the terms and conditions of the agreement, which include:

- conditions precedent not being met before closing;
- breaches of covenants;
- breaches of representations and warranties;
- disputes regarding due diligence and the disclosure letter;
- disputes regarding post-closing price adjustments; or
- disagreements regarding the earn-out adjustments.

Differences from litigation brought by shareholders

35 How does litigation between the parties to an M&A transaction differ from litigation brought by shareholders?

Litigation between parties to M&A transactions most commonly occurs post-closing. This includes claims for breach of the transactional documents and misrepresentation claims.

Litigation brought by shareholders is usually pre-closing, and aimed at protecting shareholder interests either through direct claims or claims in the name of the company.

Hogan Lovells

Chris Dobby
chris.dobby@hoganlovells.com

Grace Zhu
grace.zhu@hoganlovells.com

11th Floor, One Pacific Place
88 Queensway
Hong Kong
Tel: +852 2840 5629/5605
Fax: +852 2219 0222
www.hoganlovells.com

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