Thailand

Negotiated M&A Guide

Corporate and M&A Law Committee

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Negotiated M&A transactions of private limited companies in Thailand are usually made in the form of a share purchase or an asset purchase. The share purchase is made between the acquirer and the existing shareholders of the target company, although sometimes the target company also agrees to be a party to the share purchase transaction. The asset purchase is made between the acquirer and the target company that owns the assets. This article discusses the practices and requirements of negotiated M&A transactions, in the form of acquisitions of shares or assets of private limited companies, registered in Thailand.

1. Preliminary Review

An M&A transaction normally starts with the acquirer obtaining basic information about the share structure of the target company and its assets and liabilities. A potential purchase price of the shares or the assets, based on fair market value, is roughly estimated at this stage, subject to adjustment at the negotiation stage. Other issues discussed at the preliminary stage include employment matters, licenses, major assets and liabilities and the general business operation of the target company.

2. Letter of Intent

Before proceeding with legal due diligence and other due diligence reviews, the acquirer will send a letter of intent (the "**LOI**") to the shareholder who wants to sell shares in the target company.

The LOI sets out the major terms and conditions of the transaction. It can cover major legal and commercial issues that need to be negotiated before the execution of a Share Purchase Agreement ("**SPA**") or an Asset Purchase Agreement ("**APA**"). The significant clauses that should be contained in the LOI are:-

(1) Intent: Both parties express their intent to enter into the M&A transaction, subject to a legal due diligence review and execution of the SPA or the APA. The basic details of the shares or assets to be acquired and their price, or a formula for the calculation of the price, are the important part of the LOI.

(2) Due diligence: In a major acquisition transaction, several due diligence investigations, including legal, accounting, tax, engineering, are included in the LOI. A due diligence period is also set out. During the due diligence period, the selling shareholder normally agrees not to discuss with any other potential acquirer.

(3) Undertakings: The LOI can also set out initial terms and conditions to be included in the SPA or the APA if, after completion of the due diligence investigation, the acquirer decides to proceed with the SPA or the APA.

The LOI is signed by the acquirer and the shareholder. It can constitute a legal agreement enforceable against the parties or a mere letter of intent with no legal force, depending on how the parties draft the applicable provisions. It is a common practice for the target company to also sign the LOI to ensure that it is aware of the potential acquisition transaction and to facilitate the due diligence investigation by the acquirer.

3. Legal Due Diligence

Legal due diligence is one of the most important due diligence exercises for a merger or an acquisition transaction. To conduct legal due diligence, a checklist should be prepared to set out the scope of the due diligence and the documents required to be reviewed. The target company will need to be cooperative in providing most of the documents required for the legal due diligence.

The major matters which are normally covered in legal due diligence are as follows:-

(1) Corporate Matters

(a) Registration Details

The registration details of the target company as registered with the Ministry of Commerce ("**MOC**") should be obtained and reviewed. These include officially certified copies of the company's affidavit, memorandum of association, articles of association ("**AoA**"), list of shareholders and other registration documents. The review of the corporate matters of a target company should focus on its registered name, address, capital, objectives, AoA and shareholders. The authorization of the directors and who can act for the company must also be determined to ensure that the directors who sign the transaction documents for the target company have the power to sign such documents and bind the company. A private limited company must have at least 3 shareholders and it must have a share register book showing details of the shares and shareholders. The share register book contains the records of all transactions related to the shares. Restrictions on share transfers may be specified in the AoA.

(b) Restricted Business Activities

The shareholding structure of the target company must be reviewed. There are foreign ownership limits under the Foreign Business Act B.E. 2542 ("**FBA**"). A company with foreign shareholders holding more than 49% of its total shares is a "foreigner" under the FBA and it cannot operate certain restricted business activities unless it has obtained a foreign business license from the Foreign Business Committee ("**FBC**") or an investment promotion certificate from the Board of Investment or a permit for land use and business operation from the Industrial Estate Authority of Thailand. Some of the restricted business activities include production and sale of weapons, air and land transportation, accounting and engineering services and the selling of food or beverages. In general, service businesses are restricted business under the FBA, except for those exempted under the MOC Ministerial Regulations such as securities business, asset management, life insurance and non-life insurance, services to government sectors.

(c) Resolutions

Minutes of the board of directors and shareholders meetings of the target company for the past few years should be reviewed. A company is required to hold an annual general meeting ("**AGM**") of shareholders at least once a year to approve its annual financial statements, appoint directors to replace the directors who retired by rotation, and appointment of its auditor and his remuneration. An extraordinary general meeting ("**EGM**") of shareholders is required for approving other important matters, such as appointment of a new director, relocation of the company address and increase of the registered capital. A board of directors resolution and/or a shareholders resolution is normally required under the AOA for major financial or commercial transactions of the company.

(2) Employment Matters

The employment contracts, the work rules, the code of conduct and all announcements related to employees of the target company should be reviewed to ensure that they comply with the minimum requirements under the labour protection law, such as the working hours, working days, holidays, annual leave, salary payment and severance pay. All of the employment or service agreements with the senior management team should also be reviewed. If the target company outsources its employees from a workforce service sub-contractor, the law requires the company to be liable to the sub-contract employees as if it were the direct employer. The terms and conditions of the employment service agreement between the target company and the sub-contractor should be reviewed.

A company and its employees are required to be registered with the Social Security Fund ("**SSF**") and contribute funds to the SSF monthly. A company is also required to be registered with the Workmen Compensation Fund ("**WCF**") and contribute funds annually to the WCF. The documents showing that the target company has been registered with the SSF and the WCF and paid its monthly contributions to the SSF and its annual contributions to the WCF should be reviewed.

A provident fund scheme is not required by law. But it is normal for a large company to have a provident fund arrangement, whereby the company is required to pay monthly contributions to the provident fund in the same amounts as the monthly contributions of the employees. Documents related to the provident fund arrangement and the monthly contributions should be reviewed. The target company may also provide other benefits, such as profit sharing, medical insurance and life, insurance to its employees. A review of documents on these benefits is recommended.

(3) Material Agreements

The target company may have entered into many material agreements related to its assets and business operations. Material agreements can include shareholders or joint venture agreements, land and building purchase or lease agreements, plant or machinery purchase agreements.

The due execution and the validity and enforceability of the material agreements must be reviewed. Their material terms and conditions should be considered carefully. Obligations and penalties in case of a breach must be reviewed. Agreements between the target company and its directors or their related parties should be reviewed very carefully.

(4) Major Assets

The major assets of a target company can include lands, buildings, factories, inventories, machines, motor vehicles and investments in other businesses. Land ownership is evidenced by a land title deed or "Chanode". There are several other kinds of land documents in addition to the land title deed. These include certificates of land utilization and notices of possession.

The official copies of the said land documents and all agreements related thereto should be obtained from the land office and reviewed. If the ownership in the target company is more than 49% foreign, it is prohibited from holding land ownership, except for a few cases, such as holding the ownership of land in an industrial estate under the law on industrial estates or other laws.

A land lease for more than three years is required to be registered with the land office, otherwise it will be enforceable only for three years. A long-term land lease cannot be registered for a term longer than 30 years.

A company can create busines collateral over its businesses, accounts receivable, inventory, intellectual property, moveable and immovable properties, etc., to secure its own debt or obligations of another person under the business collateral law. A business collateral agreement must be made in writing and registered with the Business Collateral Registration Office at the MOC. Only basic information of registered business collateral agreements is available to the public.

(5) Licenses and Permits

If the target company owns and operates a factory, all required licenses and permits must be in place. These include at least the licenses for construction of the factory, operating the factory business and using the land for an industrial purpose. If the target company leases a factory, a factory lease agreement and documents showing ownership of the machinery used in the factory should be reviewed. Companies are required to hold several other kinds of licenses and permits depending on their business activities and shareholding structures.

(6) Environmental Law Issues

Most of the large scale industrial and real property projects are required to comply with the law on protection of the environment and the law on national health protection. The major requirement for large scale projects is an environment impact assessment ("**EIA**") study or the environment and health impact assessment ("**EHIA**") study. The Ministry of Natural Resource and Environment ("**MNRE**") has determined the types and sizes of projects which need the EIA or the EHIA with approval of the National Environment Board. The EIA or the EHIA reports that predict the impacts of the projects on the environment and the human health must be approved by the Office of the Natural Resources and Environmental Policy and Planning and the Expert Review Committee. But for smaller projects located in environmental protection areas as prescribed by the MNRE, e.g. Phuket, Krabi, Petchaburi, Chonburi, etc., an initial environment examination ("**IEE**") study is required. Thus, if the business operation of the target company requires the IEE, the EIA or the EHIA reports, the evidence showing that the said reports have been approved and that all the relevant and subsequent filings and compliances have been fully made by the target company must be reviewed.

(7) Intellectual Property

The target company may own patents and trademarks. Documents showing that they have been registered with the relevant authorities should be reviewed. The target company may also own copyrights in literary works (including computer software), dramatic works, artistic works, musical works, audio-visual materials, motion pictures, sound recordings, broadcasting works, or any other work of literature, science or fine art. Copyright works are not required to be registered although it may be deposited with the Copyright Office. All the intellectual property license agreements made by the target company as a licensor or a licensee must also be reviewed.

(8) Borrowings and Liabilities

The target company may have obtained loans or other credit facilities from financial institutions or other creditors. Credit facilities agreements and collateral agreements must be reviewed. Liabilities of the target company can arise also from agreements related to financial transactions, such as guarantee agreements, swap and derivatives agreements, factoring agreements, assignment agreements, etc.

(9) Disputes and Litigations

It is possible that the target company is a party to existing disputes or lawsuits, either as a plaintiff or a defendant. An existing dispute can lead to a civil or criminal lawsuit in the future. An insolvency and bankruptcy search should also be made against the target company with the Central Bankruptcy Court and the Legal Execution Department.

After completion of the legal due diligence review by the legal counsel, a legal due diligence report is prepared for the acquirer to review before deciding on whether or not to proceed with entering into the SPA or the APA.

4. Basic Requirements for the Acquisition of Shares

(1) Shareholders and Votes

A Thai private limited company must have at least three shareholders at all times. Some important matters, such as increase of the registered capital and amendment to the AoA of a company, require votes of shareholders holding at least 75% of the total shares. Thus, the acquirer who acquires more than 25% of the voting shares in the target company effectively holds the blocking vote for important matters of the target company and therefore holds some controlling power over its operation and management. A preference share structure is allowed. A preference share structure for the purpose of

avoiding the foreign ownership limits under the FBA could be subject to investigation by the MOC and/or the Department of Special Investigation ("**DSI**").

(2) Share Transfer Deed

If the acquired shares are represented by a share certificate in the name of the shareholder, the transfer of the shares from the shareholder, as the transferor, to the acquirer, as the transferee, must be made in a written share transfer deed signed by the transferor and the transferee and witnessed by at least one witness, otherwise the share transfer will be void. The share transfer deed must specify the details of the shares and the consideration for the share transfer. The share transfer deed must also be affixed with a duty stamp at the rate of THB1 for every THB1,000 of the paid-up value of the shares and its duplicate must be affixed with a duty stamp at the rate of THB1 if the original share transfer deed is subject to the duty stamp of not more than THB5 or THB5 if the original share transfer deed is subject to the duty stamp of more than THB5. Otherwise, the share transfer deed cannot be used as evidence in Court. The details of the share transfer must be recorded in the share register book of the target company so that the share transfer can be enforced against the company and a third party. The company must submit a new list to the MOC of its shareholders, showing the details of the acquirer as a new shareholder, within 14 days from the share transfer date.

5. Acquiring Existing Shares and Newly Issued Shares

(1) Acquiring Existing Shares

The acquirer may acquire the existing shares from one or several of the existing shareholders or acquire the newly issued shares on a capital increase in the target company. Unless the AoA of the target company requires otherwise, the selling shareholders can sell the shares that they own in the target company without obtaining approval from the other shareholders or the board of directors of the target company.

(2) Acquiring Newly Issued Shares

If the shares to be acquired are newly issued specifically for the purpose of the acquisition by the acquirer, the target company must increase its registered capital.

To increase the registered capital of the target company, a special resolution must be passed at a shareholders meeting. First, the newly issued shares must be offered in writing to the existing shareholders in proportion to their current shareholdings. If they waive their rights to subscribe for the newly issued shares, then the newly issued shares still cannot be sold to the acquirer until after it has become a new shareholder of the target company. In practice, the acquirer will first acquire at least one existing share in the target company from an existing shareholder so that the acquirer becomes an existing shareholder and is then entitled to purchase all the newly issued, after all other existing shareholders have waived their pre-emptive rights to buy the newly issued shares. The increase of the registered capital must be registered with the MOC within 14 days from the date of passing the special resolution.

(3) Protection of Minority Shareholders

If the acquirer acquires less than 25% shares in the target company and becomes a minority shareholder, the acquirer should negotiate with the selling shareholder to include protection measures for minority shareholders in the AoA of the target company. For example, the AoA can be amended to require that decisions of the company on important matters must receive approval of the shareholders holding more than 75% votes of the total shares. The SPA may also provide that the acquirer is entitled to appoint a director to the board of directors of the target company and that the vote of the said director is required at all times for any major transaction made by the target company.

6. Share Purchase Agreement

(1) Drafting SPA

Once the legal due diligence reviewed is completed and the acquirer decides to proceed with the acquisition, an SPA will be drafted and negotiated. There is no rule as to who will draft the SPA. In practice, the SPA is normally drafted by the legal counsel of the acquirer. But the draft SPA will be negotiated and revised until both parties find it acceptable.

(2) Standard Clauses of SPA

The length and complexity of the SPA will depend on the issues and details required by the parties to be included in the SPA. The SPA normally includes the following standard provisions.

(a) Details of Acquired Shares:

The number and type (ordinary or preference) of the shares to be acquired must be specified. These are not normally a big issue of negotiation. But it is important for the ownership of the shares, their certificates and their encumbrances (if any) to be clearly specified in the SPA.

(b) Price and Payment:

The purchase price and the method of payment, such as payment by a wire transfer of funds, are normally specified. The price can be paid at one lump sum or split into instalments and paid at different stages, such as upon signing the SPA, completion of the conditions precedent and fulfilment of the conditions subsequent (if any). The payment can be paid directly to the seller or to an escrow agent. Receipt for the payment should be issued and delivered to the acquirer upon the seller receiving the payment.

(c) Conditions Precedent:

The important conditions precedent can include consent, permission or approval from the other shareholders, the board of directors of the target company, the creditors or relevant official authorities. But the most important conditions precedent are the transfer of the acquired shares and the payment of the purchase price. Completion of the transaction should not take place until all of these conditions are fully satisfied. If the target company is also a party to the SPA, approval from its shareholders for it to enter into the SPA and to perform its obligations thereunder must be granted by a shareholders meeting.

(d) Management of Target Company:

The acquirer normally appoints one or more new directors to the target company. The directors who represented the selling shareholder normally resign as a condition precedent to completion. Appointment of a new director nominated by the acquirer must be approved by a meeting of the shareholders of the target company. The resignation and appointment of directors must be registered with the MOC within 14 days.

(e) Representations and Warranties:

The seller and the target company should be required to represent and warranty that they have power and authority to enter into the SPA and perform their respective obligations thereunder. The shareholder and the target company must represent that the shares and the assets are free and clear from any pledge, option, charge, lien or any other encumbrance and that the entering into the SPA and their performance of their obligations thereunder will not violate any law or regulation or constitute a breach of an existing agreement with any third party.

(f) Term and Termination:

The SPA should be valid and enforceable until completion of the acquisition. Each party should be entitled to terminate the SPA with or without cause. The causes of termination can include an event where a party has breached its major obligations under the SPA, become bankrupt or insolvent or there has occurred an event of a force majeure.

(g) Dispute Resolution:

A dispute resolution mechanism by mediation or arbitration should be negotiated and specified. The number of mediators or arbitrators, the venue, the rules and the language of the mediation or arbitration should be specified. If the dispute cannot be settled by mediation or arbitration, then one of the parties can file a claim with the court of jurisdiction. If the claim is filed with a foreign court outside Thailand, the judgment of the foreign court cannot be readily enforced in Thailand. The winning party must file a fresh lawsuit in Thailand and adduce the foreign judgment as evidence in the Thai court proceeding.

(h) Governing Law and Jurisdiction:

The parties can agree that the SPA be governed by Thai law or foreign law and that the Thai court or a foreign court is the court of jurisdiction. If the target company is in Thailand, the governing law should be Thai law and the court of jurisdiction should be the Thai court. This is mainly because enforcement of the SPA against the selling shareholder and the target company and their Thai assets needs to be made in Thailand.

(i) Escrow Agent:

An escrow agent can be appointed to hold all or part of the funds for the payment of the purchase price and the share ownership documents from execution of the SPA up to completion of the acquisition. An escrow agent is a financial institution, such as a commercial bank, with a license issued by the Ministry of Finance. An escrow agreement must be made amongst at least the acquirer, the shareholder and the escrow agent. If there is any dispute between the parties, the escrow agent can not deliver the shares to the acquirer nor pay the purchase price to the shareholder until the dispute has been settled or the court has given a final judgment.

7. Basic Requirements for Acquisition of Assets

Assets of a target company that are normally acquired are lands, buildings, factories, machineries, claims, accounts receivable and other rights and entitlements. If the acquirer is a foreign legal entity or a Thai company owned more than 49% by a foreigner, it is prohibited by the Land Code from holding land ownership. Thus, a foreign acquirer of lands must ensure that it or its acquiring vehicle registered in Thailand is not owned more than 49% by foreigners. There are a few exceptions, including the investment promotion granted by the Board of Investment and the acquisition of land located in an industrial estate zone under the law on industrial estates.

Acquisition of assets from a company is not required by law to be approved by its shareholders or board of directors. But its AoA may require a transfer of assets with a high value be approved by a shareholders meeting or a board of directors meeting.

8. Asset Purchase Agreement

The APA is generally made between the acquirer and the target company as the owner of the acquired assets. The major shareholders of the target company may also sign the APA to confirm that they will make the target company perform its obligations under the APA. The major terms and conditions of the APA are similar to those of the SPA. But some additional clauses specifically applicable to an acquisition

of assets may need to be included to meet the relevant legal requirements. For example, land purchase requires registration with the land office and acquisition of accounts receivable requires a notice given to the debtor of the receivables. The APA is preferred in the case where the acquirer wants to buy only some assets of the target company.

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