

PANEL ON TAKEOVERS AND MERGERS

**China Strategic Investment Limited ("China Strategic")
Offers for Pacpo Holdings Limited ("Pacpo")**

time, the following appointments of financial advisers were announced : CEF Capital to China Strategic; ING to shareholders of Pacpo other than Red Hill and Pacific Concord; and Standard Chartered Asia Limited ("Standard Chartered") to the shareholders of HKBLA other than Pacific Concord, Red Hill and Pacpo.

3. The Executive ruled that ING was not considered to be sufficiently independent to give advice to Pacpo's minority shareholders on the Pacpo offer for Pacpo because ING had acted on behalf of Red Hill and Pacific Concord in relation to an offer by Red Hill for shares in Pacpo only about nine months previously. The Executive's ruling was not based on any doubts regarding ING's competence or conduct.

Code Issues Regarding Independence of Financial Adviser

4. Rule 2 of the Code is a new Rule introduced in the revision of the Code which became effective 1 April, 1992. The purpose of the Rule is to ensure that minority shareholders in both the offeror and offeree companies are provided with independent advice as to the merits of an offer.

5. Rule 2.1 addresses, specifically, the obligations which fall upon the board of an offeree company which receives an offer or is approached with a view to an offer being made. Rule 2.1 provides that, "A board which receives an offer, or is approached with a view to an offer being made, should, in the interest of shareholders, retain an independent financial adviser to advise the board as to whether the offer is, or is not, fair and reasonable.... If any of the directors of an offeree company is faced with a conflict of interest, the offeree board should, if possible, establish an independent committee of the board to discharge the board's responsibilities in relation to the offer."

6. There are a number of other paragraphs contained in Rule 2 which address particular types of transactions and circumstances. There are also some notes to the Rule which provide further guidelines. Paragraphs 2.6 and 2.7 provide examples as to the types of persons who would most likely not be suited to give independent advice. Note 1 provides some examples of possible conflicts of interest. Note 2 deals with a particular situation regarding an offer made by or with the co-operation of controlling shareholders. Paragraphs 2.6 and 2.7 and Notes 1 and 2 are set out in **Appendix 1**.

7. Rule 2 is, along with all the other Rules of the Code, subject to the overriding statement in the Introduction to the General Principles that "it is impracticable to devise rules in sufficient detail to cover all circumstances which can arise in offers. Accordingly, persons engaged in offers should be aware that the spirit as well as the precise wording of

Executive's decision.

Code Issues Regarding Chain Principle Offer Price

12. Note 8 to Rule 26.1 provides :

The chain principle

Occasionally, a person or group of persons acquiring statutory control of a company (which need not be a company to which the Code applies) will thereby acquire or consolidate control, as defined in the Code, of a second company because the first company itself holds a controlling interest in the second company, or holds voting rights which, when aggregated with those already held by the person or group, secure or consolidate control of the second company. when acquired by a person or group of persons who are not the same person or group of persons who acquired the first company.

15. The precedents for calculating the relevant prices under the chain principle have mainly been based on asset values. Whilst, in other situations, earnings may be more important than asset values when assessing what the appropriate price should be, the Panel concludes that, taking into account the nature of the businesses of Pacpo and HKBLA, asset values should be the basis for calculating the offer price in this case. The relevant asset values should be assessed on the information available to the offeror as at the time the transaction was entered into. In this case, the transaction entered into was a fixed-price deal with no possibility

17. Accordingly, the Panel rules that, under the chain principle, the appropriate price to be offered to HKBLA shareholders is \$20.43 per share.

Appendix I

2.6

2. *Offer made by or with the co-operation of controlling shareholders.*

The requirements for competent independent advice for shareholders is of particular important in respect of offer made by or with the co-operation of controlling shareholders. An independent adviser for the independent shareholders is essential and its responsibility is reasonable. Because of this, it is all the more important that its competence and independence from the parties involved should be beyond question. In such cases, the reasons for advice are of particular importance.

The Executive will normally require the formation of an independent committee of the offeree's board of directors in these cases if it is possible for an independent committee to be formed. The responsibilities of the committee would include instructing and dealing with the independent adviser, and generally protecting the interests of the independent shareholders.