TAKEOVERS AND MERGERS PANEL

Panel Decision
in relation to Alibaba Health Information Technology Limited
(formerly CITIC 21CN Company Limited, Stock Code 241)

Purpose of the hearing

1. The Takeovers and Mergers Panel (the "Panel") met on 22nd and 23rd April, 2016 to consider a referral by the Takeovers Executive under Section 10.1 of the Introduction to the Codes on Takeovers and Mergers and Share Buy-backs (the "Takeovers Code") which relates to a particularly novel, important or difficult point at issue. Accordingly, this was a non-disciplinary hearing.

2. The Panel was invited to determine whether:

   - the agreement entered into between Mr. Chen Wen Xin ("Mr. Chen") and Hangzhou Ali Venture Capital Co., Ltd., a subsidiary of Alibaba Group Holding Limited, which with its subsidiaries or any of them is referred to as "Alibaba", constituted a special deal under Rule 25 of the Takeovers Code;

   - and if it did, whether the whitewash waiver granted to Alibaba in respect of its acquisition of a majority interest in Alibaba Health Information Technology Limited, formerly known as CITIC 21CN Company Limited, Stock Code 241, ("21CN") was invalidated; and

   - as a consequence, has a mandatory general offer obligation been triggered for the shares in 21CN not owned by Alibaba or parties acting in concert with it and, if so, at what price will the mandatory general offer obligation be made.

Background and facts

3. 21CN is a company listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Hong Kong Stock Exchange"). One of its principal operations is the development of a Product Identification, Authentication and Tracking System ("PIATS") for the healthcare and other industries. The Panel was informed that this is the only such system available to the healthcare industry in the People's Republic of China (the "PRC"). The PIATS system involves the provision of product tracking and logistics information services to manufacturers in the drugs industry and the provision of services to consumers for verifying product information and its origin. The 21CN group conducts its PIATS business for the drugs industry through its wholly-owned subsidiary, CITIC 21CN (China) Technology Company Limited ("21CN China"), and for other consumer products through its 50% held subsidiary, China Credit Information Technology Company Limited.

4. On 23rd January, 2014 when the Whitewash Transaction between Alibaba and 21CN was announced, the largest shareholder in 21CN was CITIC Group Corporation with an indirect shareholding amounting in aggregate to some 21.73% of the votes attaching to the shares in 21CN. The second largest shareholder was Ms. Chen Xiao Ying ("Ms.

Chen"), who held indirectly an interest of some 21.11% of the votes attaching to the shares in 21CN. At all material times Ms. Chen was and remains an executive director and vice chairman of 21CN and is primarily responsible for its day-to-day operations. She was Chief Executive of 21CN until 9th May, 2014. Mr. Chen is Ms. Chen's younger brother. He was not involved in the management of 21CN and, in particular, 21CN China, and does not appear to have had any prior experience in the pharmaceutical industry in the PRC. His principal business activity was the management of Shenzhen Golf Club Co., Limited from which he had also acquired the right to manage its driving range business. As at 23rd January, 2014, Mr. Chen held approximately 0.49% of the voting rights attaching to shares in 21CN. He originally acquired shares in 21CN in 2002 when he sold Joy Heaven Inc., a company owned by him, to 21CN for a consideration of HK$17 million, comprising cash of HK$2 million and an issue of shares in 21CN.

5. Mr. Chen was also the sole shareholder in Hebei Huiyan Medical Technology Co., Ltd. ("OpCo"), a company which was developing a Business-to-Customer (B2C) drug transaction platform on which online pharmacies could sell over-the-counter drugs and related products. This operation was managed by Mr. Huang Jian Liang, who had formerly worked for 21CN and had been an informal consultant to Mr. Chen since 2011 before taking a permanent position with him. Mr. Huang had an ultimate knowledge of the PRC regulatory landscape for the pharmaceutical industry and, in particular, the regulations and policies of the Hebei Provincial Food and Drug Administration ("Hebei FDA") as well as the China Food and Drug Administration ("CFDA") and it was through Mr. Huang that negotiations were conducted with these government agencies. Mr. Chen, on the other hand, was not involved in the day-to-day operation of OpCo.

6. From about April 2013 there were a number of meetings between 21CN and Alibaba, at which Ms. Chen was generally present, exploring possible avenues of cooperation between the two groups, particularly as they were related to the pharmaceutical industry. The interest became greater when Alibaba was informed that OpCo was making an application to the CFDA for a permit to allow it to operate an online transaction platform between online pharmacies and consumers for over-the-counter drugs and other related products. Alibaba had also applied for such a permit. As it turned out, only three of these permits were issued. In making its application, Hebei FDA had indicated that it would like OpCo to receive the support of 21CN China, as PIATS would be an essential requirement to an effective online sales platform. For this reason, 21CN China was a signatory to the application for the permit.

7. On 12th November, 2013, OpCo was awarded the first pilot Business-to-Consumer permit (the "B2C Permit") by CFDA one of the three permits which was valid for a year and subject to renewal thereafter. Alibaba on the other hand was not successful in its application. Following the award of the permit and after Alibaba had been informed, more specific negotiations commenced the next day and it was then that Alibaba was told for the first time that OpCo was wholly-owned by Mr. Chen and was not a subsidiary of 21CN as it had originally believed. During these negotiations, 21CN was represented primarily by 21CN's Chief Technology Officer and two consultants who had worked for Ms. Chen and for her younger brother. One of the consultants became the Chief Financial Officer of 21CN before any agreement with Alibaba had been concluded. The other was claimed by Mr. Chen to be advising him. However, when asked by the Panel Ms. Chen stated that both consultants were working for her and neither Mr. Chen nor his legal advisers sought to challenge this assertion. While Ms. Chen appeared to have no recollection of it during the Panel hearing, in Alibaba's written submissions it was stated that it was she who was asked to convey Alibaba's proposal concerning OpCo to Mr. Chen. What is clear is that Mr. Chen took no active part in the negotiations and his only involvement appears to be his signing various agreements relating to the acquisition of OpCo.

8. On 23rd January, 2014, 21CN announced that it had entered into an agreement with Alibaba (the "Whitewash Transaction") under which it would subscribe for shares in 21CN at a subscription price of HK$0.30 per share, subject to the grant of a whitewash waiver of the Rule 26 mandatory general offer obligation which would otherwise result from the subscription. The whitewash waiver was subject to the consent of the Takeovers Executive and, if that were to be granted, the approval of the shareholders of 21CN who were to receive the advice of an independent financial adviser.

9. During the due diligence process conducted by Alibaba's Hong Kong lawyers it was discovered that Mr. Chen held on trust a 1% shareholding in a subsidiary of 21CN and both Ms. Chen and her younger brother were directors of it. Alibaba insisted that the 1% shareholding interest be sold so that Mr. Chen would have no connection whatsoever with 21CN or its group. It was in this context that both Alibaba and its Hong Kong lawyers received copies of the 2002 circular giving information on the sale of Joy Heaven Inc. by Mr. Chen to 21CN.

10. At the first all parties meeting in December, 2013 Alibaba's Hong Kong lawyers explained to it the key provisions of the Takeovers Code, which included the prohibition of special deals under Rule 25, unless consented to by the Takeovers Executive.

11. On the same date as 21CN and Ms. Chen entered into the Whitewash Transaction with Alibaba, Mr. Chen entered into two agreements with Alibaba: the first was the agreement for his sale of OpCo to Alibaba for a cash consideration of RMB 3 million. The second was a side agreement under which Alibaba, amongst other things, agreed to use its commercially reasonable endeavours to transfer to OpCo its operation for all the sale of over-the-counter drugs to the internet platform operated by OpCo. In addition, the parties agreed to reorganise OpCo into an offshore shareholding platform in which Mr. Chen would receive a 10% interest and which would now be the sole vehicle for Alibaba to sell over-the-counter drugs online in the PRC. Collectively, these agreements are referred to as the "OpCo Agreement" which could be terminated, or unwound, if the transfer of Alibaba's business to OpCo or the offshore reorganisation had not taken place within six months or the B2C Permit awarded to OpCo was not renewed for a period of at least a year.

12. On 21st March, 2014 a circular relating to the Whitewash Transaction was despatched to shareholders of 21CN. Neither the circular nor the preceding announcement contained any reference to OpCo, the B2C Permit or the OpCo Agreement.

13. On 7th April, 2014, the shareholders of 21CN voted by a large majority to approve the Whitewash Transaction. Neither Ms. Chen nor her younger brother voted at the shareholders' meeting because the Hong Kong Stock Exchange had required that Ms. Chen and any of her associates, which included her brother, should not vote in light of her involvement as a party to the Whitewash Transaction agreement.

14. On 30th April, 2014 the Whitewash Transaction was completed. On this date, Mr. Chen and Alibaba entered into a further side agreement under which Mr. Chen undertook, amongst other things, to use his reasonable endeavours, to assist 21CN China and the CFDA in executing a framework agreement in a form satisfactory to Alibaba with respect to the construction, operation, maintenance and management of the "China Drug PIATS Regulatory Platform".

15. In November, 2014, OpCo's B2C Permit was renewed for a further year and, although a number of conditions to which the OpCo reorganisation were subject had not been fulfilled, steps were taken to form a new company (the "Target Company") which

acquired Alibaba's online pharmacy business and the economic interest in OpCo with the result that Mr. Chen received a 9.56% shareholding in the enlarged company. This was slightly lower than the percentage specified in the 23rd January, 2014 side agreement and is accounted for by the enlargement of the business scope of the Target Company from what was originally intended in January.

16. On 15th April, 2015, 21CN announced the proposed acquisition of the Target Company in which Alibaba held a 90.44% shareholding interest with the balance being held by Mr. Chen. The consideration for this acquisition which was valued at approximately HK$19.5 billion was the issue of shares in, and convertible bonds of, 21CN to Alibaba and shares in 21CN to Mr. Chen. Based on the issue price of the shares in 21CN of HK$5.28, this valued Mr. Chen's interest in the Target Company at some HK$1.6 billion. The transaction constituted a reverse takeover under the Listing Rules of the Hong Kong Stock Exchange and it was through the vetting process in connection with this that the shareholding of Mr. Chen in 21CN came to light.

17. On 31st March, 2016, 21CN announced that it would no longer proceed with the proposed acquisition of the Target Company as the long stop date has been reached and in the light of the substantial regulatory uncertainties in relation to the medical and healthcare industry in the PRC.

18. At the time of the meeting following the award of the B2C Permit to OpCo held on 13th November, 2013, the closing share price of 21CN was HK$0.51. Immediately before the suspension of the shares pending the publication of the 23rd January, 2014 announcement, the shares in 21CN closed at HK$0.83. Trading resumed on 24th January, 2014 following the publication of the terms of the Whitewash Transaction, and the shares in 21CN closed at HK$3.92. Since then the shares in 21CN have traded in the range of between HK$14.32 and HK$2.19 and for the most part well in excess of HK$4.00. When the Panel met the shares in 21CN traded in the range of between HK$5.31 and HK$5.01.

The relevant provisions of the Takeovers Code

19. A fundamental principle of the Takeovers Code is the equality of treatment of shareholders in the context of a takeover or merger transaction, which for this purpose includes a whitewash waiver transaction. This is set out in General Principle 1 which states:

"All shareholders are to be treated even-handedly and all shareholders of the same class are to be treated similarly."

20. To give effect to this General Principle, Rule 25 of the Takeovers Code prohibits transactions between an offeror, or potential offeror, and parties acting in concert with it and a shareholder in the offeree company. Since its Notes give example of transactions which are considered to be special deals and how such transactions are to be treated, the Rule and its Notes are quoted in full:

"Special deals with favourable conditions

Except with the consent of the Executive, neither the offeror nor any person acting in concert with it may make any arrangements with shareholders or enter into arrangements to purchase or sell securities of the offeree company, or which involve acceptance of an offer, either during an offer or when an offer is reasonably in contemplation or for 6 months after the close of such offer if such arrangements have favourable conditions which are not to be extended to all shareholders.

Notes to Rule 25:

1. Top-ups and other arrangements

An arrangement with special conditions attached includes any arrangement where there is a promise to make good to a vendor of shares any difference between the sale price and the price of any subsequent successful offer or any other price top-up arrangements. An irrevocable commitment to accept an offer combined with an option to put the shares should the offer fail will also be regarded as such an arrangement.

Arrangements made by an offeror with a person acting in concert with it, whereby shares in the offeree company are purchased by the person acting in concert on the basis that the offeror will bear all the risks and receive all the benefits, are not prohibited by this Rule 25. Arrangements which contain a benefit or potential benefit to the person acting in concert (beyond normal expenses and carrying costs) are, however, normally prohibited. In cases of doubt, the Executive must be consulted.

2. Finders' fees

The Rule also covers cases where a shareholder in an offeree company is to be remunerated for playing a part in promoting an offer. The Executive will not normally consent to such remuneration unless it can be demonstrated that the arrangement is on normal commercial terms and that a person who had performed the same services, but had not at the same time been a shareholder, would have been entitled to receive no less remuneration. It is not acceptable for such remuneration to be shared with any other shareholder of the offeree company. The Executive must be consulted at the earliest opportunity in all circumstances where this Note may be relevant.

3. Management retaining an interest

Sometimes an offeror may wish to arrange for the management of the offeree company to remain financially involved in the business. The methods by which this may be achieved vary but the principle which the Executive is concerned to safeguard is that the risks as well as the rewards associated with an equity shareholding should apply to the management's retained interest. For example, the Executive would not normally find acceptable an option arrangement which guaranteed the original offer price as a minimum. The Executive will normally require, as a condition of its consent, that the independent adviser to the offeree company publicly states that in its opinion the arrangements with the management of the offeree company are fair and reasonable. In addition, where the offeror and the management of the offeree company together hold more than 5% of the equity share capital of the offeree company, the Executive will also normally require such arrangements to be approved at a general meeting of the offeree company's shareholders. At this meeting the vote must be a vote of independent shareholders. Holdings of convertible securities, warrants, options and other subscription rights may also be relevant in determining whether a general meeting is required, particularly where such rights are exercisable during an offer. The Executive must be consulted in all circumstances where this Note may be relevant.

4. Disposal of offeree company assets

In some cases, certain assets of the offeree company may be of no interest to the offeror. There is a possibility, if a shareholder in the offeree company seeks to acquire the assets in question, that the terms of the transaction will be such as to confer a special benefit on him; in any event, the arrangement is not capable of being extended to all shareholders. The Executive will normally consent to such a transaction, provided that the independent adviser to the offeree company publicly states that in his opinion the terms of the transaction are fair and reasonable and the transaction is approved at a general meeting of the offeree company's shareholders. At this meeting the vote must be a vote of shareholders who are not involved in or interested in the transaction (otherwise than solely as shareholders of the offeree company). Where such a sale of assets takes place after the relevant period, the Executive will be concerned to see that there was no element of pre-arrangement in the transaction.

The Executive will consider allowing such a procedure in respect of other transactions where the issues are similar, e.g. a transaction with an offeree company shareholder involving offeror assets.

5. Repayment of shareholder loans

A repayment to a shareholder of indebtedness due by the offeree company, or an assignment by a shareholder to the offeror or a person acting in concert with the offeror of a debt due from the offeree company, may be considered as a special deal under this Rule 25. The Executive would normally consent to such repayment or assignment if it is an arm's length transaction on normal commercial terms, subject to compliance with all the requirements under Note 4 to Rule 25."

21. Practice Note 17 sets out in summary the Takeovers Executive's current approach to special deals. The relevant part of which reads as follows:

"The Panel endorsed the Executive's current approach to special deals which can be summarised as follows:

(i) If a special deal arrangement is capable of being extended to all other shareholders, it should be so extended;

(ii) If a special deal arrangement is not capable of being extended to shareholders but the special benefit received by the counter-party shareholder(s) can be quantified, the value of the benefit should be appropriately reflected in the offer price;

(iii) If a special deal arrangement is not capable of being extended and the special benefit conferred on the counter-party shareholder(s) cannot be quantified, in cases where considered appropriate, the Executive may consent to these deals subject to compliance with the requirements of Note 4 to Rule 25, in particular, that (a) an independent financial adviser to the offeree company publicly states that in its opinion the terms of the transaction are fair and reasonable; and (b) the transaction is approved at a general meeting of the offeree company's shareholders who are not involved in or interested in the transaction.

Examples of the third type of arrangement mentioned above include:

(a) Sale of assets between the offeror and a shareholder – most often by its very nature the sale of an asset is not capable of being extended to all shareholders. In practice difficulties arise regarding such sales if they constitute special deals and cannot be valued (such as the sale of a brand or an asset that includes "goodwill" value) and hence it is not possible to extend the benefit to all shareholders;

(b) The entering into of business, shareholders' or other co-operation agreements between the offeror and a shareholder – again it is often highly problematic if not impossible to ascribe an objective value to an agreement, in particular, one that relates to co-operation; and

(c) Service and management agreements between the offeree company and outgoing shareholders or senior management – examples of such incentives might be enhanced contractual terms, share options grants from the offeror, or a position on the board of the offeror. Given that management incentives can be substantial, the Executive believes that the process for applying for the Executive's consent to service or other management contracts should be no less stringent than that for a disposal of offeree assets (i.e. the full Note 4 requirements should apply)."

22. The grant of a whitewash waiver by the Takeovers Executive is subject to the compliance by the person seeking the waiver with a number of the Rules of the Takeovers Code and failure to comply risks the invalidation of a waiver once granted. Rule 25 is one such rule. The relevant part of paragraph 2 of Schedule VI of the Takeovers Code, the Whitewash Guidance Note, which requires compliance with Rule 25, reads as follows:

"…Such grant [of a whitewash waiver] will be subject to:-

…(d) compliance by the person or group seeking the waiver with the following Rules of the Takeovers Code, where relevant:-
…

(x) Rule 25 (special deals);…"

23. Consultation with the Takeovers Executive is encouraged by the Takeovers Code when there is any doubt about a proposed course of action. This is set out in Section 6.1 of the Introduction to the Takeovers Code which states:

"When there is any doubt as to whether a proposed course of conduct is in accordance with the General Principles or the Rules, parties or their advisers should always consult the Executive in advance. In this way, the parties can clarify the basis on which they can properly proceed and thus minimise the risk of taking action which might be a breach of the Codes."

24. Since the issue arose during the hearing on whether the Panel should exercise its discretion if it felt that the provisions of the Takeovers Code would operate in an inappropriate manner, we reproduce the wording of Section 2.1 of the Introduction of the Takeovers Code which sets out the way in which the Takeovers Code is interpreted: firstly with reference to its General Principles, then specific Rules to give effect to these General Principles and lastly the spirit of the General Principles to give effect to their

underlying purpose. Also it is here that the Panel is given a specific discretion to modify or relax a rule in certain circumstances. Section 2.1 states the following:

"The Codes share common definitions and the General Principles. The General Principles are essentially statements of good standards of conduct to be observed in takeovers, mergers or share buy-backs. The General Principles are expressed in broad general terms and do not define the precise extent or the limits of their application. The Executive and the Panel apply the General Principles in accordance with their spirit and may modify or relax the effect of the language to achieve their underlying purposes.

In addition to the General Principles, each of the Codes contains a series of Rules, some of which are effectively expansions of the General Principles and examples of their application and others are rules of procedure designed to govern specific types of takeovers, mergers or share buy-backs. Although the Rules are expressed in more detailed language than the General Principles, they, like the General Principles, are to be interpreted to achieve their underlying purposes. Accordingly, each of the Codes, through the General Principles, may apply to situations not specifically covered by any Rule. Therefore, the spirit of the Rules must be observed as well as their letter and the Executive and the Panel may each modify or relax the application of a Rule if it considers that, in the particular circumstances of the case, strict application of a Rule would operate in an unnecessarily restrictive or unduly burdensome, or otherwise inappropriate, manner."

The case of the Takeovers Executive in summary

25. Rule 25 is drafted in straightforward terms and the test of whether an arrangement is a special deal is a question of fact. Concurrent with the Whitewash Transaction, Alibaba, the whitewash applicant, entered into an arrangement with Mr. Chen, a shareholder of 21CN, which had favourable conditions which were not extended to other shareholders. Accordingly, the OpCo Agreement is a special deal.

26. Rule 25 is designed to give practical effect to General Principle 1 in that all shareholders of the same class are to be treated similarly. Its underlying purpose is not restricted to arrangements which are designed to encourage a shareholder to influence the outcome of an offer or whitewash. A plain reading of the Rule and its Notes makes it apparent that the provisions are not limited to special deals designed to influence a counterparty shareholder to accept an offer or to vote in favour of a whitewash. None of the Notes to Rule 25 requires inducement. On the contrary, in the examples of special deals given in the Notes, to which the Takeovers Executive might give its consent, it is for the party seeking consent to demonstrate, among other things, an absence of inducement. Even then, the arrangement normally requires independent shareholders' approval and the consent of the Takeovers Executive. While Alibaba submits that the Takeovers Executive will not consent to a special deal which included an inducement or a distinct incentive to a shareholder to exercise its rights in a particular manner in connection with an offer or subscription, this does not mean that the converse is true. There does not need to be an inducement or distinct incentive to the shareholder for the arrangement to constitute a special deal under Rule 25. If what Alibaba contends is correct, Rule 25 would be superfluous where a shareholder receiving a special benefit is precluded from voting.

27. Alibaba also argued that Rule 25 is designed to prevent an offeror entering into an arrangement with a shareholder, because he is a shareholder. While Rule 25 would certainly apply to such arrangements, it must be apparent from its wording that it covers a much wider range of transactions than this. Notes 2, 3, 4 and 5 expressly treat

arrangements as special deals where the shareholder is not acting in the capacity of a shareholder but as a finder, management, acquirer of assets and creditor.

28. Rule 25 applies to an arrangement between an offeror and a shareholder, even if the offeror does not know that the person is a shareholder. This is illustrated by the case in 2008 of E-2 Capital (Holdings) Limited which inadvertently breached Rule 25 by disposing of assets to a shareholder during an offer period. In this case, the Takeovers Executive permitted the transaction to be put to independent shareholders in accordance with the requirements of Note 4. The approval was obtained before the offer for its shares closed. There is no mention in Rule 25 itself or its Notes about any element of knowledge. The Rule and its Notes apply to the facts and it is a fact that Mr. Chen was a shareholder, whether Alibaba knew it or not.

29. The fact that an arrangement may be fair and reasonable or priced at fair value does not mean that it cannot confer a special benefit, which is not extended to all shareholders. This is illustrated by arrangements which fall under Notes 4 and 5 to Rule 25 which require an independent financial adviser to state that in its opinion the terms of the transaction are fair and reasonable. Such an opinion does not mean that no special benefit is conferred on the relevant shareholder. It certainly does not mean that Rule 25 no longer applies.

30. Alibaba accepted that exploratory discussions were underway but suggested that they were not the same as pre-arrangements. The Executive did not accept this argument. It considered that the arrangements with Mr. Chen were more than exploratory in nature. Rule 25 does not require a contract to be in existence; an arrangement is sufficient. An arrangement has a wider meaning than an agreement or contract and need not be legally binding. As it was, the OpCo Agreement was far more: it was a series of contracts subject to certain terms. Further the fact that the interest in the Target Company was contingent or conditional did not mean it did not have significant value. The value of that contingent or conditional right should reflect the special condition and not, as Alibaba's expert witness suggested, the difference between the consideration to be received and its fair value.

31. In its submissions Alibaba had referred to a number of London precedents. While there have been times when the approach of the London Panel has provided useful guidance in the interpretation of the Takeovers Code, care should be taken to view London's precedents in their own context. The application of a Rule can differ due to differences and different concerns in each market. In Hong Kong most listed companies are controlled by their board members, unlike London. Also the City Code does not apply the special deal prohibition to a whitewash, other than in relation to management retaining an interest. This was confirmed by the decision of the Panel concerning Regent Pacific Group Limited [30th March, 2000] when it decided that it could determine a matter without recourse to a detailed understanding of current London practice.

32. Finally, Alibaba suggested that the scope of the Takeovers Executive's interpretation is unworkable because there must be many offerors whose group members have entered into arrangements during or after an offer period with counterparties in ignorance of the fact that they are shareholders. In response to this, the Takeovers Executive asked the Panel to view the present case in its own context. This was not a remote transaction with an offeror's concert party. The OpCo Agreement and the Whitewash Transaction were closely connected, the negotiations were conducted in parallel involving the same closely connected parties.

33. The Panel asked the Takeovers Executive whether it thought that, even if Mr. Chen was not a shareholder, whether it would have regarded the OpCo Agreement as falling within

the ambit of Rule 25, given the close relationship between him and his sister. In answer, the Takeovers Executive stated that it would have weighted on its mind, given the closeness of the relationship, and that it appeared to it that they acted as one. Certainly had this matter been raised at the time of the whitewash waiver application, the Takeovers Executive would have made further enquiries about the relationship between them. As it happened, as Mr. Chen was a shareholder, it did not have to pursue this line of enquiry.

34. If the OpCo Agreement was a special deal, the next question is whether the Panel should invalidate the whitewash waiver. In this regard, the Takeovers Executive agreed with Alibaba that the Panel has the discretion to rule that the whitewash waiver is not invalidated , having regard to Section 2.1 of the Introduction to the Takeovers Code. In exercising its discretion the Panel should only do so if all the relevant circumstances merit it. In this regard, the Takeovers Executive pointed to, among other things, the close connection between 21CN and OpCo in its approach to Hebei FDA and the CFDA, the obvious involvement of people either working for 21CN or Ms. Chen in the negotiation of both transactions and the absence of any real involvement by Mr. Chen, the efforts Alibaba Hong Kong lawyers made to remove Mr. Chen as a shareholder of record of one of 21CN's subsidiaries, the admission by Alibaba that it had at the outset explored the possibility of integrating OpCo and its over-the-counter drug online platform with 21CN, and its failure to consult with the Takeovers Executive when it knew of the close connection between Ms. Chen and her younger brother. This is not a technical matter. The shareholders of 21CN were denied a fundamental protection under the Takeovers Code in terms of similar treatment of shareholders of the same class. On the basis of all the facts and the importance of General Principle 1 and Rule 25, the whitewash waiver should be invalidated.

35. If the whitewash waiver were to be invalidated, a mandatory general offer obligation would arise. The question was then at what price should the offer be made. The Takeovers Executive rejected the notion that the offer price should be HK$0.30 as this price did not reflect the favourable conditions received by Mr. Chen which is consistent with Rule 25 read in conjunction with Practice Note 17 and the precedent cases of China Oriental Group Company Limited and Zhengzhou Gas Company Limited, where an offer had been raised to reflect the favourable conditions of a special deal.

36. In this matter, the Takeovers Executive had looked at a number of different bases for determining an appropriate offer price but each proved to be unsatisfactory. The Takeover Executive, therefore, considered that the most appropriate precedent was Jademan (Holdings) Limited [10th October, 1990] where the Takeovers Committee, the predecessor of the Panel, ruled that the price should be the market price at the time the offer obligation was triggered. In the Jademan case two shareholders who had acquired their shares in Jademan independently of each other came together when one shareholder redeemed his shares from one mortgage arrangement by funds advanced from another mortgage arranged by the other shareholder. As part of these arrangements that other shareholder had the right to vote the mortgaged shares. In the Jademan case there was no acquisition of voting rights attaching to shares which could form the basis for determining the offer price. If the Panel were to agree that the Jademan case was the appropriate precedent, the offer price for the shares in 21CN would be the price at which they traded on the day the Panel invalidated the whitewash waiver. On the basis of the closing price on Friday, 22nd April, 2016, the trading date preceding the Panel's decision, the price per share in 21CN to be paid under the mandatory general offer would have been HK$5.11.

The case of Alibaba in summary

37. Alibaba agreed that Rule 25 is derived from General Principle 1 and its underlying purpose is to give effect to this General Principle. The real mischief at which the Rule is directed is arrangements under which a shareholder, in his capacity as a shareholder, is offered a favourable arrangement in order to induce him to accept an offer or, in this instance, to support a Whitewash Transaction. This motivation is completely absent in this case. Indeed, neither Mr. Chen nor Ms. Chen voted their shares in 21CN in support of the Whitewash Transaction. Ms. Chen was also only one member of a nine member board so her support alone for the Whitewash Transaction was not sufficient to guarantee the board's approval of it. Further, Mr. Chen's shareholding in 21CN was insignificant and the agreements between him and Alibaba had nothing to do with and were entirely separate from the Whitewash Transaction. The two arrangements were not inter-conditional. For these reasons, the arrangements between Mr. Chen and Alibaba fell outside the scope of Rule 25.

38. In order to make this distinction, counsel for Alibaba differentiated a transaction which engaged Rule 25 and one which breached that Rule. A transaction which may engage the Rule would be one which was entered into without regard to whether a person was a shareholder or not. The example was given of a customer of a utility company, who may be a shareholder, although the utility company would have no knowledge of this. If Rule 25 included all such transactions it would be impossible to comply with it as a practical matter, particularly as the transaction fell outside the scope of the underlying purpose of the Rule.

39. At the time that Alibaba entered into the Whitewash Transaction, it did not know that Mr. Chen was a shareholder. In the absence of a knowledge of this fact, it is difficult to see how the "*mischief*" the Rule was designed to address could occur. In this regard, Alibaba referred to a UK Takeover Panel Code Committee Consultation Paper which noted that the restrictions of Rule 16 of the City Code, the equivalent of Rule 25 in the Takeovers Code, *"should normally only apply to the extent that an offeror, or any person acting in concert with it, knows or ought reasonably to know, that the person with whom the arrangement is proposed is a shareholder in, or otherwise interested in shares of, the offeree company".* Alibaba's lawyers in Hong Kong and the PRC had conducted a detailed and appropriate due diligence without the fact of Mr. Chen's shareholding in 21CN being discovered.

40. In relation to the 2002 circular giving information on the connected transaction between 21CN and Mr. Chen concerning its acquisition from him of Joy Heaven Inc., it was submitted that this document was not read with a view to establishing whether Mr. Chen was a shareholder but rather to understand the arrangements under which he held a 1% interest in a subsidiary of 21CN held on trust. Further, this transaction happened some twelve years before the Whitewash Transaction and the due diligence exercise in Hong Kong had confined itself to the last three years.

41. The OpCo Agreement itself did not contain any favourable conditions, it was an arm's length transaction under which Mr. Chen received no more than was properly due to him. Through OpCo he had a very valuable permit and he exchanged it for cash and a contingent or conditional minority shareholding in the Target Company. If it was a transaction which simply reflected the market value, it could not have contained any value in excess of that, which would represent a favourable condition. In this regard it was important not to impute a value to these arrangements which could not possibly be known at the time the agreements with Alibaba were entered into. The value ascribed to Mr. Chen's shareholding in the Target Company on 15th April, 2015 cannot have been anticipated more than a year earlier. Reference was also made to a London Panel

decision in the case of British & Commonwealth Holdings plc/Mercantile House Holdings plc in connection with Rule 16 of the City Code which confirmed that a favourable condition would be one that comprised a special benefit over and above its market value.

42. In the Takeovers Executive's Panel Paper, reference had been made to Mr. Chen and his sister being concert parties by presumption. Alibaba did not believe that the meaning of "*shareholder*" was to be extended to include parties with a similar relationship as presumed concert parties and this had not been the way that the Rule had been interpreted previously. This was why Alibaba's Hong Kong legal advisers saw no reason to consult the Takeovers Executive in advance. Concert party activity is directed to arrangements between parties with the objective of acquiring or consolidating control. This was absent in this case. Further, Alibaba was adamant that it was not acting in concert with Mr. Chen and had no reason to do so.

43. Overall, the OpCo transaction did not fit within the ambit of Rule 25. It was not the kind of transaction it was designed to regulate, it was an entirely separate matter unrelated to the Whitewash Transaction. Alibaba had no reason to think it was dealing with a shareholder and the arrangements did not contain favourable conditions. Even if for some technicality it did fall within its ambit, Section 2.1 of the Introduction to the Takeovers Code gave the Panel a clear discretion to waive or modify the application of the Rule in accordance with its underlying purpose.

44. The OpCo Agreement to the extent the Panel considered it to be a special deal could be rectified by shareholders now. This would be a more appropriate line of action than insisting on a mandatory general offer at a price which is most unlikely to be accepted by any shareholder. The value of the favourable condition is almost impossible to assess and, in these circumstances, following the Notes to Rule 25 and Practice Note 17 the approach would generally be to seek the approval of independent shareholders and the confirmation by an independent financial adviser that the terms were fair and reasonable. Were this approval not to be obtained, arrangements could be made at the Panel's direction to unwind the arrangements.

45. On the question of the price to be offered if a mandatory general offer were to be required, it could only be at HK$0.30. This is the price at which Alibaba acquired a majority interest in 21CN. Any other price would be arbitrary.

The Panel's decision and its reasons for it

46. For the reasons set out below, the OpCo Agreement is emphatically a special deal under Rule 25. It is an arrangement between a shareholder of 21CN and Alibaba or a party acting in concert with it which was entered into in the period between when the Whitewash Transaction was in reasonable contemplation and six months following its completion, which arrangement had favourable conditions that were not to be extended to other shareholders.

47. The underlying purpose of Rule 25 is derived from General Principle 1 which requires that all shareholders of the same class are treated similarly. This is a fundamental principle of the Takeovers Code. As can be seen from the Notes to Rule 25 and Practice Note 17 the transactions the Rule seeks to address go much wider than ones in which a shareholder is induced to accept or promote an offer or whitewash transaction. It is unnecessary for the Takeovers Executive or the Panel to show that inducement was the underlying purpose of the arrangement. In its examples of special deal arrangements which may not be capable of being extended to other shareholders, Practice Note 17 specifically mentions under sub-paragraph (b) "*the entering into of business… or other*

co-operation agreements between the offeror and a shareholder". The OpCo Agreement was, in part, a business agreement.

48. The argument was advanced by Alibaba that the OpCo Agreement was not related to the Whitewash Transaction and it was not inter-conditional with it. The Panel rejects this line of argument. It is apparent that the OpCo Agreement was an important, if not vital, element of a proposal by Alibaba which also included the acquisition of a majority shareholding in 21CN. OpCo held a valuable permit which was seen as essential for the development of Alibaba's over-the-counter drug online platform. So was the PIATS which had been developed by 21CN China. Indeed the side agreement between Mr. Chen and Alibaba entered into on 30th April, 2014 specifically links them by requiring Mr. Chen to undertake to assist 21CN China and the CFDA in executing a framework agreement in respect of the construction, operation, maintenance and management of the PIATS regulatory platform. Nor were the OpCo Agreement and the Whitewash Transaction seen as being independent of each other when they were negotiated. They were negotiated largely by the same people who were employees of 21CN or consultants only for Ms. Chen and on occasion Ms. Chen herself and they were negotiated at the same time. It was no coincidence that the OpCo Agreement and the Whitewash Transaction were entered into on the same day as each other, that they were completed on the same day as each other, or that the second side agreement was entered into on the day the Whitewash Transaction was completed. The only evidence of Mr. Chen's involvement in any of these arrangements was his signature on the relevant agreements when the terms had been agreed.

49. The Hong Kong legal advisers for Alibaba repeatedly stated in their submissions that neither they nor Alibaba knew that Mr. Chen was a shareholder of 21CN. The Hong Kong legal advisers told the Panel that they certainly knew about the OpCo Agreement with Mr. Chen and they knew he was a brother of Ms. Chen. Given the proximity of the relationship between siblings, the Hong Kong legal advisers should have been concerned that the OpCo Agreement may have fallen within the ambit of General Principle 1 and Rule 25, even if Mr. Chen was not a shareholder, and should have consulted the Takeovers Executive. However, in this matter the Panel does not have to decide whether to give effect to the underlying purpose of Rule 25, the term "*shareholder*" should be extended to include persons who are very closely associated with a shareholder.

50. It does not matter whether Alibaba or its advisers knew that Mr. Chen was a shareholder. Alibaba had been briefed by its Hong Kong advisers on the principal provisions of the Takeovers Code and were made aware of the requirements of Rule 25. Alibaba and its Hong Kong legal advisers were also provided with information which would have informed them that in 2002 Mr. Chen had become a shareholder of 21CN. All Alibaba and its advisers had to do was to ask whether he was still a shareholder before the OpCo Agreement was entered into but for whatever reason it did not make that enquiry.

51. Lastly, the Panel considers that the OpCo Agreement was an arrangement which had favourable conditions. The argument was advanced by Alibaba that a favourable condition should only be one that gave a greater value to an asset than could be obtained from another party. As the OpCo Agreement did not, Rule 25 should not apply. The Panel does not accept this argument. It is apparent from the Notes to Rule 25 that the favourable condition in this context is one which may favour the shareholders concerned; that is, it is not plainly unfavourable, rather than being a consideration which exceeds the market price for an asset or service. It appears, therefore, that a favourable condition is one in which a positive value or benefit is received by the shareholder under an arrangement with the offeror and not something in excess of this. This would be consistent with the Panel's decision in the case of China Oriental Group Company

Limited [6th December, 2007] where arrangements between a potential offeror and a controlling shareholder contained provisions which were favourable and under which the shareholder may have received value, even though the arrangements contained provisions which may have reduced value also.

52. In this case, it is clear that the sale of OpCo which essentially held a B2C Permit in exchange for cash and the possibility of receiving 10%, later reduced down to 9.56%, of Alibaba's over-the-counter drug online platform resulted in Mr. Chen receiving a positive consideration. That is sufficient to be an arrangement to which Rule 25 applies. The Panel does not need to determine whether the consideration received was more valuable than OpCo.

53. If the OpCo Agreement is a special deal as the Panel believes it is, then it is a clear breach of Rule 25 as the Takeovers Executive had not given its consent to it. It follows that, if the whitewash waiver was granted to Alibaba by the Takeovers Executive subject to, among other things, compliance with Rule 25, Alibaba's breach of Rule 25 will invalidate the whitewash waiver, unless the Panel exercises its discretion to allow the whitewash waiver to remain valid.

54. The argument was advanced by Alibaba that the Panel should exercise its discretion as it is permitted to do under Section 2.1 of the Introduction to the Takeovers Code. However, the Panel does not accept that the invalidation by it of the whitewash waiver would in the particular circumstances of the case cause the operation of Rule 25 and Schedule VI to operate in an unnecessarily restrictive or unduly burdensome or otherwise inappropriate manner. The clear intention of Schedule VI of the Takeovers Code, which sets out, among other things, the transactions which will disqualify a whitewash waiver application and the Rules of the Takeovers Code which remain applicable to a whitewash transaction, is that failure to comply with the basis on which the whitewash waiver is granted should result in the waiver being invalidated.

55. Rule 25 is a major concession to the strict operation of General Principle 1. The consent of the Takeovers Executive to a special deal, particularly one which is not specifically covered by the Notes to the Rule, is not a foregone conclusion. The Takeovers Executive gave no indication that, had it known about the OpCo Agreement, it would have given its consent to it at the time when the application was made for the whitewash waiver. In normal circumstances, it should follow that a breach of a Rule to which a whitewash waiver is subject, should result in the whitewash waiver being invalidated. This will place a discipline on successful applicants for a whitewash waiver to adhere strictly to the conditions under which the whitewash waiver is granted.

56. The suggestion was made that instead of invalidating the whitewash waiver, the OpCo Agreement could be ratified by independent shareholders who would be independently advised in the manner contemplated by Note 4 to Rule 25. The Panel found difficulties with this suggestion. First it would assume that the Takeovers Executive's consent to the OpCo Agreement would have been forthcoming in the first place and there is no certainty that this is the case. Further, difficulties would arise, were the independent shareholders of 21CN to vote against the OpCo Agreement, as the Panel has no authority to compel the parties to that agreement to unwind it.

57. If the whitewash waiver is invalidated following the breach of Rule 25, it follows that a mandatory offer obligation has arisen for Alibaba, unless that obligation is waived. It is clear by its wording that a Rule 26.1 mandatory general offer obligation can be waived with the consent of the Takeovers Executive and, accordingly, the Panel. However, given the centrality of this Rule to the Takeovers Code, waivers should be granted only

in the most exceptional circumstances, other than the circumstances when a waiver is permitted under the Notes to Rule 26.1 and Notes on dispensations from Rule 26.

58. In this case, the Panel considers that the starting point for any offer must be HK$0.30, being the price at which Alibaba subscribed for shares in 21CN which resulted in it becoming its majority shareholder. The Panel does not consider that the Jademan case provides an appropriate precedent. In the Jademan case, there were no purchases of voting rights attaching to shares; in this case clearly there was.

59. The difficulty which both the Panel and the Takeovers Executive have faced is to make an adjustment to the base offer price of HK$0.30 which reflects the favourable terms received by Mr. Chen. When the OpCo Agreement was entered into there was no certainty that he would receive any shares in the Target Company. Obviously this contingent or conditional right had value but placing a precise value on it presents problems.

60. The Panel also had regard to the price performance of the shares in 21CN since the agreements with Alibaba were announced. The unaudited consolidated net tangible asset value of 21CN at 30th September, 2015 is some HK$0.19 per share. Yet the shares in 21CN have traded for a sustained period since the Whitewash Transaction was announced at multiples above this and the price at which the shares in 21CN were issued to Alibaba. It is also apparent that most, if not all, of the increase in the price of the shares in 21CN is attributable to Alibaba itself and the market's expectation of the value it can add to 21CN. An offer at the market price would result in Alibaba paying a substantial amount for the value which was largely attributable to its anticipated contribution to 21CN. This does not appear to be either fair or reasonable. Further, whatever additional value that the Panel may have determined should have been added to the base offer price of HK$0.30, it was most unlikely to be material in the context of the prevailing market price of the shares in 21CN or the prices at which they have traded for over the more than two year period since the Whitewash Transaction was announced. For these reasons, the Panel has decided to waive the mandatory general offer obligation which would have otherwise arisen for Alibaba on the invalidation of the whitewash waiver granted to it by the Takeovers Executive.

61. Finally, the Panel wishes to place on record that, to the extent there is any discrepancy between the reasons given in the brief oral summary of the decision at the end of the hearing and this written decision, the written reasons should prevail.

17th May, 2016

Parties:

The Takeovers Executive, advised by Mr. Laurence Li

Alibaba Group Holdings Limited, advised by Mr. Benjamin Yu S.C., Slaughter & May and Freshfields Bruckhaus Deringer. Expert witness – Rothschild (Hong Kong) Limited

Ms. Chen Xiao Ying, advised by Mr. Daniel Fung S.C. and H M Chan & Co.

Mr. Chen Wen Xin, advised by Mr. Jose-Antonio Maurellet and O'Melveny & Myers

Alibaba Health Information Technology Limited, advised by Debevoise & Plimpton