

TAKEOVERS AND MERGERS PANEL

**Conditional Cash Offer on behalf of Eastland Enterprises Inc.,
a wholly-owned subsidiary of Emperor (China Concept) Investments Limited,
for Hong Kong Daily News Holdings Limited**

Independence of Financial Adviser

Anglo Chinese Corporate Finance, Limited

Introduction

1. On 26 September 1994 the Panel considered a referral by the Takeovers and Mergers Executive arising from a request by Anglo Chinese Corporate Finance, Limited ("Anglo Chinese") to act as the independent financial adviser to the independent committee of the board of directors of Hong Kong Daily News Holdings Limited ("HKDN") in relation to the conditional cash offers (the "Offers") by South China Capital Limited ("South China") on behalf of Eastland Enterprises Inc. ("Eastland"), a wholly-owned subsidiary of Emperor (China Concept) Investments Limited ("Emperor China"), to acquire all the issued shares (the "Shares") and outstanding warrants (the "Warrants") of HKDN.

Background

2. The Offers are mandatory general offers made in compliance with Rule 26 of the Code as a result of the acquisition of Shares by Eastland through the voluntary exercise of the subscription rights for 2,740,000 Warrants. Prior to the exercise, Eastland, Emperor China and parties acting in concert with them held approximately 34.5% of the Shares and approximately 47.4% of the Warrants. The exercise of the Warrants was sufficient to increase the holding of Eastland, Emperor China and parties acting in concert with them to approximately 35.2%, thereby exceeding the 35% threshold of Rule 26. The offer prices for the Shares and the Warrants, namely \$1.62 and \$0.62 respectively, are the minimum offer prices permitted under the Code based on the maximum price of \$1.62 paid by Eastland, Emperor China or parties acting in concert with them for Shares during the six months preceding the announcement of the Offers, the last closing price of the Shares before the announcement of \$1.60, and the exercise price for the Warrants of

\$1.00.

3. In October 1992 Anglo Chinese made an offer on behalf of Emperor China (then called Bo Shing Holdings Limited) for Lolliman Holdings Limited ("Lolliman"). Lolliman was then an investment holding company whose subsidiaries were principally engaged in property investment and management and investment holding. Its most significant non-property investments were its 45% interest in Best Fulfil Inc. and its approximately 33% interest in HKDN.

4. In June 1993 Emperor China and Emperor International Holdings Limited ("Emperor International"), an associated company of Emperor China, entered into a conditional agreement for the disposition of their aggregate indirect 60% shareholding in Lolliman. At the same time Lolliman entered into a conditional agreement to transfer its 33.2% interest in HKDN to Emperor China. Anglo Chinese was initially appointed to advise the independent committee of the board of directors of Lolliman in respect of the resulting general offer for Lolliman and Lolliman's disposition of HKDN to Emperor China, but the Panel ruled that appointment to be inappropriate (the "Lolliman Decision").

5. Anglo Chinese acted for Emperor China and Emperor International on various other matters during 1992 and 1993, generally rendering advice on regulatory issues. The most recent of these matters occurred in August 1993. In addition, Anglo Chinese was the independent adviser to the other shareholders in connection with the disposal of the Right Emperor Commercial Building by Emperor International in December 1992. From 1992 Emperor China and Emperor International have also retained other merchant banks in Hong Kong as their financial advisers and to act on their behalf in connection with fund raising and other transactions.

6. The Offers were announced by Emperor China and HKDN on 19th September 1994 for publication in the newspaper on the following day. In accordance with the Code, Anglo Chinese consulted the Executive on whether it could act as the independent financial adviser in relation to the Offers on being approached by HKDN on the date of the announcement. The Executive referred the matter to the Panel for a ruling.

Code Issues

7. Rule 2 of the Code was introduced in the revision of the Code which became effective on 1 April 1992. The purpose of Rule 2 is to ensure that minority shareholders of both the offeror and offeree company are provided with independent advice as to the

merits of an offer.

8. Rule 2.1 specifically addresses the obligations which fall upon the board of the offeree company. It provides that a "board which receives an offer, or is approached with a view to an offer being made, should, in the interests of shareholders, retain an independent financial adviser to advise the board as to whether the offer is, or is not, fair and reasonable".

9. Other paragraphs of Rule 2 and notes to the Rule address particular types of transactions and circumstances and provide further guidelines. Rule 2.6 provides: "A person who has, or had, a connection, financial or otherwise, with the offeror or offeree company of a kind likely to create a conflict of interest will not be regarded as a suitable person to give independent advice." Rule 2.7 provides that "a financial adviser will not normally be considered to be independent if he is considered to have a relationship with the offeror, the offeree company, or the controlling shareholder(s) of either of them, which is reasonably likely to affect the objectivity of his advice." Note 1 provides some examples of possible conflicts of interest. Note 2 deals with the particular importance of independent advice for offers made with the co-operation of controlling shareholders. Rule 2.6 and 2.7 and Notes 1 and 2 are attached as **Appendix 1**.

10. The facts are similar to those of two earlier cases. On 5 January 1993 the Panel decided that it would not be appropriate for Internationale Nederlanden Capital Markets (Hong Kong) Limited ("ING") to act as the independent adviser to the minority shareholders of Pacpo Holdings Limited ("Pacpo") in connection with the offer resulting from the sale of control of Pacpo where ING had acted on behalf of the parties selling control of Pacpo in connection with their acquisition of control only about nine months previously. In ruling that ING was not sufficiently independent, the Panel based its decision on the "fact that there was a relationship earlier in the year" between ING and the controlling shareholder of the offeree company.

11. The Lolliman Decision concerned the appointment of Anglo Chinese as the independent financial adviser in connection with an offer and related special deal under Rule 25 where Anglo Chinese had been retained by the controlling shareholder of the offeree company in an unrelated matter during the same month, and Anglo Chinese also had been retained by the controlling shareholder of the offeree company eight months previously in relation to the acquisition of control of the offeree company by that controlling shareholder. The Panel followed its decision in relation to Pacpo, and in doing so referred to the relationship in the prior decision as existing within the preceding twelve

months.

Decision

12. The Panel decided that it would not be appropriate for Anglo Chinese to act as the independent financial adviser to the independent committee of the board of HKDN in relation to the Offers. In doing so, the Panel followed the decisions in the Pacpo and Lolliman cases. The Panel considered that it is important that minority shareholders of an offeree company perceive the financial adviser to be totally independent of the offeror. The Panel had no doubts whatsoever as to the competence of Anglo Chinese.

13. The Panel considers the lapse of time since the financial adviser to an offeree company has had a relationship with an offeror to be a relevant factor, but the time that must lapse depends on the particular facts of each case. The Panel will take into account whether the parties have engaged in other transactions in which other financial advisers have been retained and the small size of the merchant banking community in Hong Kong. In this case the Panel placed particular importance on the fact that the Offers were part of a series of transactions involving HKDN directly or indirectly and the Offers were thus linked to the offer by Anglo Chinese for Lolliman on behalf of Emperor China in which Emperor China indirectly acquired most of its current interest in HKDN. The Panel also noted that the offer for Lolliman was not an isolated transaction involving Anglo Chinese, which had also acted for Emperor China and Emperor International on various other matters.

14. The Panel emphasises that this case resulted from a consultation by Anglo Chinese and the proceedings were not of a disciplinary nature. The Panel appreciates the fact that Anglo Chinese consulted the Executive on this matter promptly.

10 October 1994

Attach.

Appendix I

2.6 Persons not suited to give independent advice.

A person who has, or had, a connection, financial or otherwise, with the offeror or offeree company of a kind likely to create a conflict of interest will not be regarded as a suitable person to give independent advice.

2.7 Independent financial advisers and independent shareholders

A financial adviser will not normally be considered to be independent if he is considered to have a relationship with the offeror, the offeree company, or the controlling shareholder(s) of either of them, which is reasonably likely to affect the objectivity of his advice. If there are shareholders who are not independent because they have an interest in the proposed transaction other than their interest as a shareholder of the offeror or offeree company, as the case may be, the independent adviser should endeavour to represent the best interest of the offeror or the offeree company, respectively, by concerning itself only with the interests of the independent shareholders, i.e. those shareholders of the company who have no interest in the proposed transaction other than their interest as a shareholder of the company.

Notes

1. Conflicts of interest

A conflict of interest will exist, for instance, when there are significant cross-shareholdings between an offeror and the offeree company, when one or more directors are common to both companies or when a person is a substantial shareholder in both companies.

A financial adviser may have the opportunity to act for an offeror or the offeree company in circumstances where the adviser is in possession of material confidential information relating to the other party, for example, because it was a previous client or because of involvement in an earlier transaction. This will often necessitate the financial adviser declining to act, for example, because the information is such that a conflict of interest is likely to arise. Such a conflict will normally be incapable of resolution simply by isolating information within the relevant organisation or by assigning different personnel to the transaction.

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

The requirements for competent independent advice for shareholders is of particular importance 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.