

TAKEOVERS AND MERGERS PANEL

involvement in the transaction as adviser to the offeror, would not be considered as acquisitions of shares by a person acting in concert with the offeror. As a result of this confirmation any proprietary dealings by the “public” side of the Lehman group, being its sales and trading activities as opposed to its investment banking operations, prior to 11th June, 2008 were not relevant to the matter before the Panel.

5. By 10th June, 2008 Lehman was formally retained by the offeror as its adviser. This is the first time to the knowledge of those present at the hearing that Lehman had been retained in this capacity in a takeover subject to the Code and on that date the offeror and CIFH published a joint announcement setting out the terms of the privatisation proposal in accordance with requirements of Rule 3.5 of the Code. In summary, under the scheme of arrangement, scheme members will receive, in consideration for the cancellation of their shares, one CNCB “H” share and HK\$1.46 in cash for every share in CIFH held. In anticipation of the resumption of trading on the following day, the Lehman group instituted a restriction on all proprietary trading, but not agency trading, in the shares in CIFH and CNCB by issuing an R6 notice, its highest level of trading restriction. To the knowledge of those present at the meeting this was the first time a R6 restriction had been initiated by the Lehman group in Hong Kong. Had this restriction been effective it would have stopped all proprietary trading in these shares by the Lehman group, apart from the settlement of contracts entered into before the suspension of the shares in CIFH. Further, the Lehman group arranged training sessions for its traders commencing on the following day so that they would comply fully with the R6 notice.
6. Rule 3.5 required that the announcement of 10th June, 2008 include disclosure of the Lehman group’s outstanding derivatives in relation to shares in CIFH, if such information was available. There is no evidence that those at Lehman who advised the offeror knew of the Lehman group’s outstanding derivatives at the time the announcement was published and Lehman had been retained as the adviser to the offeror.
7. At 9:30 a.m. on 11th June, 2008 trading in the shares in CIFH was resumed on the Hong Kong Stock Exchange and the Lehman group R6 trading restriction came into effect. On this date also, the Lehman group submitted to the Executive a draft application for “exempt principal trader” status under the Code. This application was subsequently withdrawn but may be renewed.
8. On 11th June, 2008 the Lehman group purchased 31,000 shares in CIFH at prices ranging from HK\$6.15 to HK\$6.17 per share. The purpose of these trades was to rebalance a hedge against existing swaps with a client on the MSCI HK Index. On the same day, Lehman group purchased a further 179,000 shares in CIFH at prices between HK\$6.22 and HK\$6.23 per share for the purpose of unwinding a short position resulting from over-the-counter sales to clients. Again on the same day, a further 72,000 shares in CIFH were purchased at prices between HK\$6.23 and HK\$6.24 per share. This trade was generated by a client without reference to any Lehman group employee by executing a “Lehman Performance Swap” through

prohibits the sale of shares in an offeree company by the offeror or persons acting in concert with it during the offer period. Accordingly, none of the Lehman group's shareholdings can be sold without the prior approval of the Executive.

The relevant provisions of the Code

16. The first principle of the Code is that in an offer all shareholders are to be treated even-handedly and all shareholders of the same class are to be treated similarly. For this reason during an offer period an offeror and parties acting in concert with it are constrained from dealing in the offeree company's shares. Normally purchases above the offer price for a cash offer will result in that offer being increased to the highest price paid or, in the case of a securities exchange offer, as in this instance, purchases for cash will result in the offer being accompanied by a full cash alternative, again at the highest price paid. The Code also places strict disciplines on a financial adviser to an offeror in respect of dealing in the shares in the offeree company and this is particularly so of an adviser which is a member of a multi-service financial group, of which fund management and proprietary trading form a significant part. The Code is unambiguous on this and any financial adviser accepting an engagement to advise on a transaction subject to the Code should be fully aware of the disciplines imposed on it and other members of its group.

The requirement for even-handed and similar treatment is set out in General Principle 1 of the Code, which reads:

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

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period which has yet to end. Under the Code, an offer period commences:

22. The consequence of purchasing shares in the offeree company during the offer period is set out in Rule 23.1(b) which states that:

Except with the consent of the Executive..... a cash offer is required where:-

...

- (b) ...shares of any class under offer in the offeree company are purchased for cash (but see Note 5 to this Rule 23.1) by an offeror or any person acting in concert with it during the offer period, in which case the offer for that class shall be in cash or accompanied by a cash alternative at not less than the highest price paid by the offeror or any person acting in concert with it for shares of that class during the offer period..."*

Rule 23.1(b) has the effect on a securities exchange offer, which was the offer being made to the scheme members of CIFH, of introducing a full cash alternative at the highest price paid in the event of purchases by the offeror or persons acting in concert with it during the offer period. There is no concept in the Code of a de minimis trade. The Rule, as with other Rules on the Code relating to the purchase of voting rights attaching to shares, makes no distinction as to the scale of purchases

24. The Code also gives a general discretion to

The decision and reasons of it

26. In the absence of a successful rebuttal of the presumption, all members of the Lehman group are persons presumed to be acting in concert with the offeror. The definition of the persons presumed to be acting in concert under paragraph 5 of the definition makes this abundantly clear. Once the details of the offer were published and the offer period commenced all purchases of shares in CIFH by the Lehman group, unless specifically exempted by the Executive in advance, were relevant to the application of Rule 23.1(b), irrespective of whether the purchases were made with the offer in mind or not or whether other members of the presumed concert party were aware of such purchases. The scale of purchases was also irrelevant to the application of this Rule. Accordingly, in the absence of the waiver of the Rule 23.1(b), the Code requires that a cash alternative be made at the highest price paid during the offer period: that is at a price of HK\$6.27 per share in CIFH.
27. The Panel then had to decide whether it was appropriate to consider the exercise of its discretion under Section 2.1 of the Introduction of the Code to waive the requirements of Rule 23.1(b). In this case, relatively small purchases by members of the financial adviser's group made for purposes which did not relate to the offer had through the application of Rule 23.1(b) potentially calamitous consequences for the offeror, which would alter and possibly undermine its privatisation proposal. These circumstances should require the Panel to consider the exercise of its discretion to waive the application of Rule 23.1(b) in this instance.
28. Having considered the representations made to it by Lehman and the Executive, the Panel decided that it should exercise its discretion to waive the requirement for a cash alternative in this case for the following reasons. These are that:
 - 4 the size of the purchases, which were unconnected with the offer, were very small relative to the size of the offer and the total volume of the shares in CIFH traded;
 - 4 given the negligible impact that these purchases had on traded prices or volume, they also had a negligible impact on public shareholders so that the even-handedness and equality of their treatment under the offer had not been compromised to any significant degree;
 - 4 the imposition of the requirement for a cash alternative would have a substantial and adverse impact on the offeror, greatly increasing the cash component of its proposal and changing the terms and possible outcome of that proposal, in circumstances where it had not purchased shares itself and had no

offer fall on the Lehman group, the remedy would be disproportionate to the scale of the purchases.

Further observations and recommendations

29. The hearing before the Panel was not a disciplinary proceeding but a referral to it under Section 10 of the Introduction to the Code. By referring a matter to the Panel, it is expected that the Panel's decision will be made public and that this will assist the market in understanding better the requirements and operation of the Code. It is in this spirit that the Panel wishes to make some observations on this matter which may have more general application than the matter before it. By its own admission and to its regret, Lehman's performance in this matter fell short of the standards expected by its clients, its regulators and also itself. It appears that the Lehman group was simply unprepared. It had never in its recall acted in this capacity in Hong Kong, it did not appear to be in a position to collate the relevant information on derivative and other outstanding commitments within a reasonable time frame, restricted dealing procedures were untried, systems were inadequate and traders were not properly trained in advance of the imposition of dealing restrictions. Had Lehman applied for and received exempt principal trader status, this embarrassment is likely to have been avoided. Early consultation with the Executive on the basis that it was fully informed of its derivative and other similar positions would have mitigated and possibly avoided some of the difficulties that were experienced. In the light of what has happened in this instance and in the hope it does not happen again, the Panel reminds practitioners and parties to a takeover transaction of the clear impositions in the Code for early consultation with the Executive and for the need for full disclosure in circumstances that might bear upon a proper consideration of the matter. In addition, the Panel wishes to advise multi-service financial groups with active fund management and proprietary trading businesses who are, or intend to be, involved in corporate finance activities and transactions which are subject to the Code of the benefits of exempt status and the importance of timely application for such status.