TAKEOVER AND MERGERS PANEL

Panel Decision

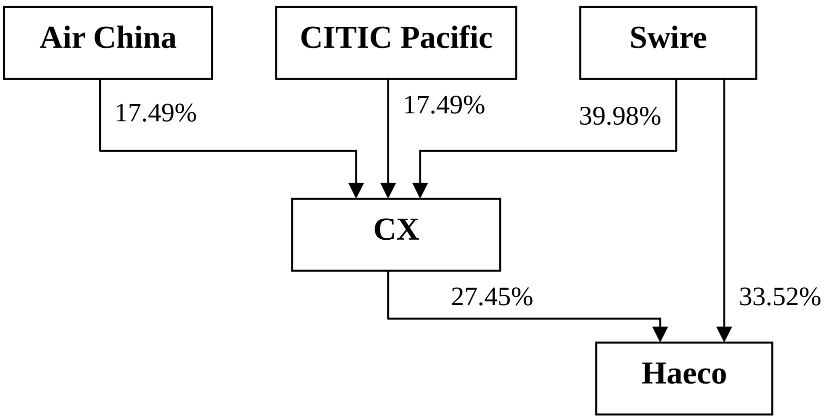
In relation to a referral by the Takeovers Executive to the Takeovers and Mergers Panel (the "Panel") for a ruling on whether the mandatory offer obligation which would result from the proposed transfer of an interest in Hong Kong Aircraft Engineering Company Limited ("Haeco") by Cathay Pacific Airways Limited ("CX") to a subsidiary of Swire Pacific Limited ("Swire") should be waived

Purpose of the hearing

1. The Panel met on 3rd December, 2008 to consider a referral by the Takeovers Executive under Section 10.1 of the Introduction to the Code on Takeovers and Mergers (the "Code"), which relates to a particularly novel, important or difficult point at issue. The Panel was asked to consider whether it agreed with the Takeovers Executive that a waiver under Note 6 of the Notes to Rule 26.1 of the Code should be granted to Swire to waive the mandatory offer obligation which would otherwise result from the proposed transfer of an interest in Haeco by CX to a subsidiary of Swire.

Background and facts

2. Swire has for many years been the largest shareholder of CX and through its direct shareholding taken together with its controlling interest in CX has had a majority interest in Haeco. At present, the shareholding structure of CX and Haeco is as follows:



3. Under a shareholders agreement dated 8th June, 2006 between Swire, CITIC Pacific Limited ("CITIC Pacific") and Air China Limited ("Air China"), which together hold 74.97 % of the shares in CX, Swire is entitled to nominate all five of the executive directors of CX and four non-executive directors, in addition to being entitled to nominate the chairman of CX. Each of CITIC Pacific and Air China are entitled to nominate two non-executive directors, of which one is entitled to be nominated as a

deputy chairman of CX. Further, four independent directors are to be nominated to the board of CX. Accordingly, under the shareholders agreement, Swire is entitled to nominate nine directors out of a board of seventeen: that is, a majority of the board.

4. Apart from the undertakings by the shareholders to support the continuation and any periodic renewal of the management services agreement between CX and John Swire & Son (H.K.) Limited, the immediate holding company of Swire, and the operating agreement between CX and Air China, the shareholders agreement does not contain any provisions for reserved matters which would require the unanimous consent of the parties to the shareholders agreement or a super majority of the directors of CX and specifically excludes the participation of CITIC Pacific and Air China, except as provided in the operating agreement between CX and Air China, in the day to day operational management of CX or its wholly-owned subsidiary, Hong Kong Dragon Airlines Limited. Accordingly, the disposition of all or a portion of its investment in Haeco or the exercise of votes attaching to its shares are not governed by any provision of the shareholders agreement.

5. These arrangements will continue provided Swire is beneficially interested in 30% or more of the shares in CX or is the largest shareholder in CX and will terminate in respect of either CITIC Pacific or Air China if their shareholdings fall below 5%. The agreement contains further provisions for nominating directors if the balance of the shareholdings of the three parties alter but they are not relevant to the matter before the Panel. The agreement also prohibits Swire from increasing its stake in CX beyond 44.9% or, in certain circumstances, 49.9% without the written consent of the other parties.

6. Under management services agreements between John Swire & Sons (H.K.) Limited and respectively, CX and Haeco, John Swire & Sons (H.K.) Limited provides a number of management services to both companies, including the provision of the full or part time services of members of the staff of the Swire group.

7. Notwithstanding the contractual entitlement of Swire to nominate a majority of the directors to the board of CX, it was agreed by both Swire and the Takeovers Executive that CX was not a subsidiary of Swire as defined in the Hong Kong Companies Ordinance. Further, the results of CX were not consolidated into the accounts of Swire; rather it was accounted for as an associate.

8. Swire has been considering putting forward a proposal to CX under which it would be able to realise a portion of its interest in Haeco at a price in excess of the current market price for the shares in Haeco while at the same time retaining Haeco firmly within the control of Swire as it regards Haeco as a long term investment.

9. It is not necessary for the purposes of this decision to describe the exact mechanics of the proposed transaction. On implementation the proposed transaction would result in the transfer of 1.90% of the issued shares in Haeco held by Swire and 16.60% of the issued shares in Haeco held by CX to a new company (“Newco”) which would be held as to 50.5% by Swire and 49.5% by CX and the effective realisation for cash of some 7.46% of the issued shares in Haeco by CX.

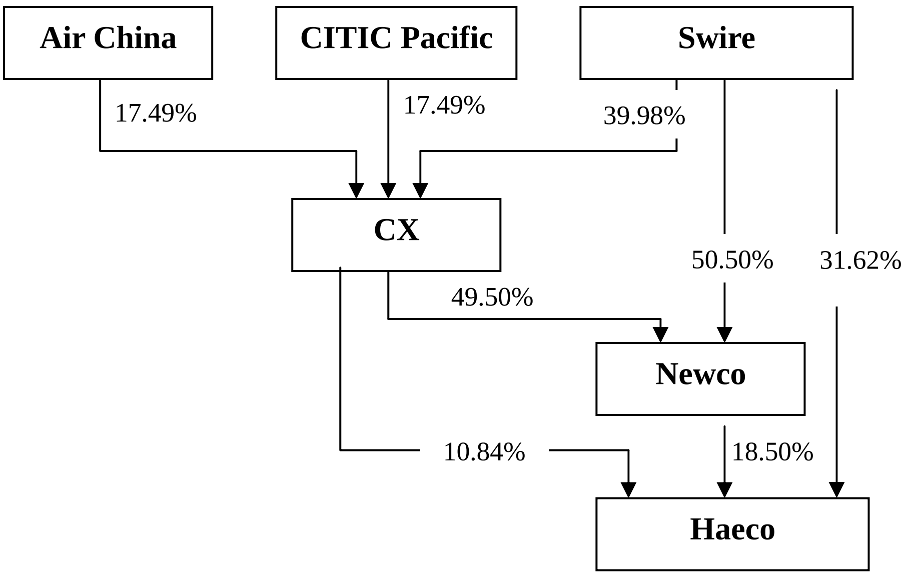
10. The price at which shares in Haeco would be transferred to Newco had not been finally

determined but it was anticipated to be HK$95 per share in Haeco and would not exceed the 180 trading-day volume weighted average price (“VWAP”) per share in Haeco, which was calculated by the financial adviser to Swire to be HK$106.56 as at 26th November, 2008.

11. The share price of Haeco at the time of the hearing and for much of the month that preceded it was HK$70 or less per share. The premium over the market price represented by an effective transfer price of HK$95 per share in Haeco was, therefore, some 35.7% or more. The 180 trading-day VWAP represented a premium of some 52.2% to the prevailing market price and 12.2% to an indicative transfer price of HK$95.

12. As part of the arrangements, CX and Swire would enter into a shareholders agreement which would entitle CX to nominate two directors out of five to the board of Newco and two directors to the board of Haeco. It was represented to the Panel that, as Haeco provided an important service to CX, it wanted to maintain an effective influence over Haeco’s operations. At present, there are no arrangements which entitle CX to nominate directors to the board of Haeco.

13. Following the implementation of the proposed transaction, the shareholding structure of CX and Haeco would be as follows:



14. Upon implementation of these arrangements, Haeco would become a subsidiary of Swire through its direct holding in Haeco and its statutory control of Newco. Accordingly, Swire’s shareholding in Haeco both directly and through a subsidiary would have increased from 33.52% to 50.12%. Conversely, while CX would retain an indirect shareholding through Newco, which would become an associated company of CX, the voting rights directly exercisable by it attaching to the shares in Haeco would decrease from 27.45% to 10.84%.

The relevant provisions of the Code

15. Acting in concert is defined in the Code as follows:

*“**Acting in concert**: Persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), actively co-operate to obtain or consolidate “control” (as defined below) of a company through the acquisition by any of them of voting rights of the company.”*

16. The definition of “acting in concert” in the Code includes a number of classes of person who are presumed to be acting in concert with each other including:

“Without prejudice to the general application of this definition, persons falling within each of the following classes will be presumed to be acting in concert with others in the same class unless the contrary is established:-

(1) a company, its parent, its subsidiaries, its fellow subsidiaries, associated companies of any of the foregoing, and companies of which such companies are associated companies...”

17. The requirements of the Code which relate to acquisitions by one member of a concert party from another which cause the purchaser’s holding to pass through a trigger point in the Code and the criteria which will be considered in granting a waiver from the resulting obligation to make a mandatory takeover offer are set out in Notes 6(a) and 7 of the Notes to Rule 26.1. Note 7 is not relevant to the matter which was before the Panel. The relevant part of Note 6(a) reads as follows:

“Whenever the holdings of a group acting in concert total 30% or more of the voting rights of a company and as a result of an acquisition of voting rights from another member of the group a single member comes to hold 30% or more or, if already holding between 30% and 50%, has acquired more than 2% of the voting rights in any 12 months period, an obligation to make an offer will normally arise.

In addition to the factors set out in Note 7 to this Rule 26.1, the factors which the Executive will take into account in considering whether to waive the obligation to make an offer include:-

(i) whether the leader of the group or the largest individual shareholding has changed and whether the balance between the shareholdings in the group has changed significantly;

(ii) the price paid for the shares acquired; and

(iii) the relationship between the persons acting in concert and how long they have been acting in concert.

The Executive would normally grant the acquirer of such voting rights a waiver from such general offer obligation if:-

(i) the acquirer is a member of a group of companies comprising a company and its subsidiaries and the acquirer has acquired the voting rights from another member of such group of companies…”

18. A subsidiary is defined in the Code as follows:

"Subsidiary has the meaning attributed to such term by the Companies Ordinance (Cap. 32) and includes any other entity whose assets and liabilities and results are consolidated in an entity's financial statements (or would be, if they were drawn up as at the relevant date)."

19. The trigger point of the Code at which a mandatory takeover offer obligation is incurred was reduced with effect from 19th October, 2001 from 35% to 30%. Transitional arrangements were put into effect for a person or a group of persons acting in concert which immediately before the change held 30% or more but less than 35% of the votes attaching to the shares in a company. These arrangements are to last for ten years from 19th October, 2001. These transitional arrangements are contained in Rule 26.6, the relevant part of which reads as follows:

"Holdings of between 30% and 35%

Where a persons, or two or more persons acting in concert, holds 30% or more of the voting rights of a company but less than 35% of such voting rights immediately prior to implementation of this Rule on 19 October 2001 then, for so long as such holding remains in this range and until 10 years after that date:-

(a) the Takeovers Code (other than this Rule 26.6) shall be interpreted and applied as if the 30% trigger in Rule 26.1(a) and (b) was 35% for such person or persons…"

20. Rule 26.1 lies at the heart of the Code and sets out the circumstances when a mandatory takeover offer obligation is incurred. The relevant part of Rule 26.1 reads as follows:

"When mandatory offer required

Subject to the granting of a waiver by the Executive, when

(a) any person acquires, whether by a series of transactions over a period of time or not, 30% of more of the voting rights of a company; [or]

(b) two or more persons acting in concert, and they collectively hold less than 30% of the voting rights of a company, and any one of them acquires voting rights and such acquisition has the effect of increasing their collective holding of voting rights to 30% of more of the voting rights of a company;…

…that person shall extend offers, on the basis set out in this Rule 26, to the holders of each class of equity share capital of the company, whether the class carries voting rights or not, and also to the holders of any class of voting non-equity share capital in which such person, or persons acting in concert with him, hold shares (see also Rule 36)."

21. A fundamental principle of the Code is the requirement for equality of treatment in the context of a takeover offer. This is set out in General Principle 1 which reads:

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

class are to be treated similarly."

The decision and the reasons for it

22. As the issues appeared to be finely balanced and any decision was likely to be used as a precedent for similar transactions in the future, the Panel considers that the Takeovers Executive was correct in referring the matter to the Panel. Undeniably this was not an easy decision to make as the Code requires the exercise of subjective judgement. However, when it reached its decision the Panel was unanimous.

23. There was no question that by presumption and in fact Swire and CX are parties acting in concert in relation to Haeco.

24. For the purposes of determining the applicable trigger point where a mandatory takeover offer would be required, the Panel considered that Rule 26.6 applied as, for the period following 19th October, 2001, Swire's direct shareholding had been maintained at more than 30%, but below 35%, of the issued share capital of Haeco. The relevant trigger point for Swire as an individual member of a party acting in concert in relation to Haeco is 35%.

25. The proposed transaction, if implemented, would result in Swire's shareholding, which would include the shares held by its subsidiary, Newco, increasing from 33.52% to 50.12%. Haeco would then become a subsidiary of Swire. In effect a new concert party would have been formed between Swire and Newco but this is a relationship between a holding company and a subsidiary so there can be no doubt that the former could exercise the votes attaching to the shares held by the latter and that their aggregate shareholding should be treated as one, irrespective of whether the subsidiary is wholly owned or not. In passing, we would add that in its submissions Swire also calculated its shareholding and that of CX on an attributable basis. This, we believe, is incorrect in the context of the Code. All the votes attaching to shares held in a company by a subsidiary should be counted and not reduced to reflect the fact that the subsidiary is not wholly owned.

26. Under Note 6(a) to the Notes to Rule 26.1, the Code envisages that acquisitions by one member of a concert party from another which cause the purchaser's shareholding to cross a trigger point in the Code will "normally" result in a mandatory takeover offer obligation arising. This must be the starting point; waivers are a concession which are granted only in a comparatively narrow range of circumstances.

27. The Note then sets out the criteria which "will" be taken into account in considering a waiver. This does not mean that other matters must be excluded in the Panel's or Takeover Executive's consideration of the exercise of its discretion to grant a waiver. The use of the word "include" makes this apparent. Rather that, in addition to any other matter, the criteria set out in the Note will be required to be taken into account.

28. Additionally, Note 6(a) makes reference to the factors which are set out in Note 7 to the Notes to Rule 26.1. In the matter before the Panel, by general agreement, none of the factors set out in Note 7 were relevant.

29. The criteria in Note 6(a) to be taken into consideration in the grant of a waiver are set

out in two paragraphs. In the first paragraph the criteria are related to acquisitions by a member of a concert party when it is not a purely domestic matter, if we can characterise it as such; that is, it is applicable to concert parties generally. The second paragraph confines itself to acquisitions by a member of a concert party from another when the relationship is particularly close, being either a company with its subsidiaries or an individual together with close relatives, related family trusts and companies controlled by the individual or close relatives. When transfers of voting rights attaching to shares are made between the persons specified in the second paragraph, any mandatory takeover offer obligation is "normally" waived.

30. For a waiver to be granted to Swire in this matter under the criteria set out in the second paragraph of Note 6(a), it would be essential that the definition of subsidiary apply to CX. The term subsidiary is defined in the Code. In short it is subsidiary as defined by the Hong Kong Companies Ordinance or an entity whose results are, or are to be, consolidated in another entity's accounts. It was agreed by all parties that, notwithstanding the shareholders and management services agreements referred to earlier, CX was not by definition a subsidiary of Swire.

31. It was argued that, although CX was not a subsidiary of Swire, if the second paragraph were to be read purposively, as it was suggested it should be, this would include CX in relation to Swire. The Panel disagrees with this argument. The second paragraph is unambiguous in the persons it includes within its ambit, particularly as it relates to a group consisting of a parent company and its subsidiaries. The exclusion of associated companies, which are included as presumed concert parties, is not an oversight. Unless a parent subsidiary or fellow subsidiary relationship can be demonstrated, based on the definition of subsidiary in the Code, the concession under the second paragraph as it relates to companies is not available. That is the purpose of this part of Note 6. In this matter, as CX is not by definition a subsidiary of Swire, the concession under the second paragraph was not available to Swire.

32. For a waiver to be granted, it was necessary as a minimum for the Panel to take into account the criteria set out in the first paragraph. In summary, the criteria relate to changes in the leadership of the concert group, whether the balance of shareholdings has changed significantly, the price paid for the shares acquired, and the relationship between the persons acting in concert and how long they had been so acting.

33. In a number of respects there is absolutely no doubt that Swire meets the requirements of the first paragraph. It is and has stated it intends to remain the leader of the concert party in relation to Haeco. The relationship between concert party members is evidently close. CX has from early on in its history been closely associated with Swire and carries its insignia. The relationship has been a very long one and has been in existence for far longer than the Code itself.

34. Therefore, the critical issues for the Panel to examine were whether the proposed change in the balance of shareholdings is significant and the price paid.

35. As has already been described, the proposed transaction increases Swire's holding in Haeco from 35.52% of the voting rights to 50.12%. CX's shareholding in Haeco over which it can exercise the voting rights decreases from 27.45% to 10.25%. For Swire, it acquires statutory control of Haeco and its control is now without any reference to others.

It is free to acquire further shares, whether in exercise of its pre-emptive right under its agreement with CX were CX minded to realise its attributable interest in Haeco held through Newco, or from any other party without incurring a mandatory takeover offer obligation under the Code. In Code terms, a transaction which results in a concert party member increasing its own shareholding from below a controlling interest, in this instance from below to 35%, to statutory control of over 50%, where the provisions of Rule 26.1 no longer apply, is significant. Even with a concert party group as close and as enduring as that between Swire and CX, it is difficult to view the proposed transaction otherwise.

36. On the question of price, a number of arguments were advanced by Swire to reduce the importance of the prevailing market price when compared to the price which CX would receive for the effective disposal of a portion of its shareholding in Haeco. Further, a distinction was drawn in relation to the assessment of the long term investment potential of Haeco by Swire and a crude premium for control. The price to be received by CX was compared to, and justified by, a 180 trading-day VWAP price of HK$106.56; a price which was calculated with reference to traded prices in a period, which extended over about nine months. What is apparent is that market conditions have deteriorated markedly over that period and with it the prospects of businesses generally. In conditions of such uncertainty it is questionable whether there is any logic in weighting a price in part to a time in the market when conditions were very different from those at present. Emphasis was also given to the thin trading of shares in Haeco, although on the evidence before it, the Panel did not find any convincing evidence that the level of trading in the shares in Haeco had been detrimental to the determination of its price on a daily basis. The comparative chart of the price of Haeco against the Hang Seng Index provided to the Takeovers Executive by the financial adviser to Swire appeared to show Haeco tracking the Hang Seng Index quite accurately and consistently, although for the best part of the year under-performing it. It is accepted that daily trading may not reflect the price at which large lines of shares change hands. Often in order to induce a person to sell his shares it is necessary to offer a substantial premium over the market price, however that premium is determined. In the context of a purchase which, but for the grant of a waiver, will result in a mandatory takeover offer arising, this must raise the issue of the equality of treatment of other shareholders which is a fundamental principle of the Code. In this case the proposed price manifestly reflected the premium over the market price that Swire believed CX would accept for a significant shareholding in Haeco and one it could recommend to its shareholders generally. That premium is substantial when compared to the prevailing price which should be the starting point of any comparison. If price is to be a consideration that is to be taken into account when considering the grant of a waiver from a Rule 26.1 mandatory takeover offer, the Note must envisage that a substantial premium is an important factor for not granting a waiver. In this regard, the Panel was informed by the Takeover Executive that in almost all waivers granted under Note 6 in the past there was no premium paid. Therefore, the present matter was not typical. The Note provides no further guidance as to what price would meet its criterion for a waiver but given the size of the premium the Panel believed that it was well beyond the price envisaged as being acceptable in granting a waiver.

37. In view of the significant change in the balance of the concert party's shareholdings and on the grounds of price, the Panel concluded that a waiver of the Rule 26.1 mandatory takeover offer obligation resulting from the implementation of the proposed transaction

did not meet in full the requirements of the first paragraph of Note 6(a) and, accordingly, a waiver should not be granted.

10 December, 2008

Parties present at the hearing:

The Takeovers Executive

Swire Pacific Limited
RBS Asia Corporate Finance Limited – financial adviser to Swire Pacific Limited
Slaughter and May – legal adviser to Swire Pacific Limited