

HKEx LISTING ENFORCEMENT GUIDANCE LETTER

Cite as HKEx-LEGL03-08 (Published in November 2008) (Updated in July 2014)

Summary	
Listing Rule	Main Board Listing Rules 2.13, <u>14A.35, 14A.36, 14A.46 and 14A.48</u> <u>14A.47, 14A.49 and 14A.52</u>
Subject	<ul style="list-style-type: none">• Guidance on who constitutes a connected person of an issuer• Guidance on what procedures an issuer should adopt to ensure compliance with the connected transactions provisions in the Listing Rules.
Contents	<u>Based on and modified from Extracts of</u> a No Further Action (Guidance) letter from an authorised signatory of the Stock Exchange of Hong Kong

[*date]

[Name and Address of Listed Issuer]

Dear Sirs,

[*Name of Listed Issuer] Limited (the “Company”)
No further action: Guidance Letter

We refer to the earlier correspondence concerning the captioned matter resting with the letter (with enclosures) from [*name of solicitors], the Company’s solicitors, dated [*day *month *year] (the “Company’s Submission”).

Materials Reviewed

The Listing Division (the “Division”) refers to the following materials which have been reviewed:

1. the Company’s announcement (the “**Acquisition Announcement**”) dated [*day *month *year];
2. the Company’s Submission dated [*day *month *year];
3. the submission by [*name of NED], a then non-executive director of the Company, through his solicitors, [*name of solicitors], dated [*day *month *year]; and
4. the Company’s announcement (the “**Termination Announcement**”) dated [*day *month *year] in relation to the termination of the Acquisition;

Thank you for the information and material provided by the Company which enables the Division to have a clearer understanding of the matter.

Facts

1. On [*day *month *year], the Company and [*name of subsidiary] (the “**Purchaser**”)

entered into an Agreement with [*name of individual] whereby the Purchaser agreed to acquire and [*name of individual] agreed to dispose of his entire interest in [*name of a company] at a consideration of [*amount] (equivalent to approximately [*amount]) (the “**Acquisition**”).

2. According to the submissions referred to above, [*name of NED] informed the Company that [*name of individual] was his sister’s boyfriend at the time when the Acquisition was entered into in [*month *year]. [*name of NED] apparently first met [*name of individual] together with his sister in [*month *year], and his sister introduced [*name of individual] to [*name of NED] as her boyfriend. Based on this representation, the Board allegedly reviewed, considered and concluded that [*name of individual]’s, relationship with [*name of NED]’s sister, would not render him a connected person of the Company under Chapter 14A of the Listing Rules.
3. On [*day *month *year], the Company published an announcement in relation to the Acquisition. It was stated in the Acquisition Announcement that [*name of individual] was a third party independent and not connected to the Company. On [*day *month *year], the Company published a circular in relation to the Acquisition. It was stated in the circular that [*name of individual] was a third party independent and not connected to the Company.
4. In fact, it emerged from a complaint sent to the Division on [*day *month *year] that [*name of individual] and [*name of NED]’s sister had been married since [*month *year]. [*name of individual] was therefore the brother-in-law of [*name of NED] at the relevant time and thus a connected party for the purposes of the Listing Rules. The submissions received assert that [*name of NED] and the Company were unaware of the extent of the relationship between [*name of individual] and [*name of NED]’s sister until alerted by the Division. The nature of that relationship was subsequently confirmed in [*name of NED]’s submission dated [*day *month *year].
5. However, on [*day *month *year], the Company announced that the Purchaser and [*name of individual] entered into a formal termination agreement with the Company on [*day *month *year]. The Acquisition had been terminated because [*name of individual] could not procure the necessary approval from the [*name of authority] and [*name of authority] for the registration of the Purchaser as the owner of [*name of company] according to the time schedule set out in the Acquisition Agreement. There is no reference to the connected relationship being part of the reason for the termination.
6. On [*day *month *year], the Company announced that the Compensation Payments of approximately [*amount] (including the consideration of [*amount] and the interest penalty of [*amount]) in connection to the termination of the Acquisition had been fully received by the Company in [*month *year].
7. On [*day *month *year], [*name of NED] retired as a non-executive Director of the Company.

Comment

1. The prima facie evidence available to us from the material referred to above suggests that [*name of individual] was in fact a connected person of the Company at the time the transaction was entered into in [*month *year].

2. The Division notes the assertion in [*name of NED]’s and the Company’s Submission that [*name of NED] and the Company were not aware of the actual nature of the relationship between [*name of individual] and [*name of NED]’s sister at the relevant time i.e. [*month] to [*month *year]. The Division also notes the Company’s submission that [*name of NED] was not involved in the negotiation leading to the signing of the agreement with [*name of individual]. As a non-executive Director, [*name of NED] was only notified at the time of the preparation of the Acquisition Announcement, when his view and declaration of interests in the transaction was sought.
3. Based on the materials available, in the Division’s view, there is prima facie evidence to suggest that the Company did not comply with Rules 2.13, 14A.35, 14A.36, 14A.46 and 14A.48~~14A.47, 14A.49 and 14A.52~~ of the Listing Rules as the Company (i) did not comply with the announcement, circular and shareholders’ approval requirements under the Listing Rules at the time when the potential connected transaction was entered into and (ii) published announcements on [*day] and [*day *month *year] which contained information which is potentially inaccurate, incomplete and misleading in relation to this transaction.
4. However, having considered the materials we have decided to take no further action in relation to this matter. In coming to this decision, the Division has noted the following factors arising subsequent to the events described above giving rise to regulatory concern:
 - (a) the Acquisition was subsequently terminated in [*month *year] and the Company received a refund of the consideration together with penalty interest. It appears therefore that shareholders’ financial interests may not have been prejudiced, although their ability to consider and make informed investment decisions may have been prejudiced in the circumstances of this case; and
 - (b) [*name of NED] has since retired as non-executive director of the Company on [*day *month *year] and consequently the connected relationship no longer exists. There is a presumption that [*name of NED] was best placed to enquire and establish the precise extent of the relationship that existed. Any breach is to some extent a function of his efforts to address this issue.

Guidance

Nevertheless the Division continues to have concerns as to the Company’s ability to identify and manage connected relationships and we believe that the following guidance may be useful to inform your compliance processes and decision making in the future.

1. The Company’s attention is drawn to the definition of connected person set out in Rule 14A.12(2)(a)~~14A.11(4)(b)~~, which includes “any person cohabiting with him /a connected person described in rule 14A.07(1), (2) or (3)] as a spouse... with a person referred to in R14A.11(1), (2) or (3)”. When a transaction is proposed to be entered into by the Company with a person and the Company is on notice that this person has a relationship with a person referred to in Rules 14A.07(1) to (3)~~14A.11(1), (2) or (3)~~, the Company should:
 - (a) make more detailed enquiries as to whether the such relationship falls within the definition of connected person under Rule 14A.12(2)(a)~~14A.11(4)(b)~~; and
 - (b) consult with the Exchange and/or external lawyers as to whether the person

falls within the definition of a connected person.

In this connection we would observe that the Company placed total reliance on the representation made by [*name of NED]. The information he provided should in our view have alerted the Company to make further and more detailed enquiries of [*name of individual] to ascertain and verify the representation made by [*name of NED]. It is possible that such enquiries may have alerted the Company to compliance issues. If the acquisition had not been terminated for the reasons given, it is possible that the Company could have been exposed to regulatory action because of the failure to identify and address the compliance issues arising from the relationship.

2. If this has not yet been done, it is advisable that the Company puts in place procedures to ensure compliance with Chapter 14A of the Listing Rules. Such procedures may include:
 - (a) establishing a list of connected persons of the Company, with a periodic review, to ensure that the list is kept up-to-date;
 - (b) ensuring that all transactions are cleared by the Corporate Governance Committee, which is responsible for overseeing the Company's corporate governance matters; and
 - (c) seeking professional advice (for example from the Company's Compliance Advisor) before transactions are entered into.
3. We are also concerned by the inaccurate announcements made by the Company on [*day] and [*day *month *year]. Pursuant to Rule 2.13, any announcement made by the Company must be accurate and complete in all material respects and not be misleading or deceptive. Where the Company is subsequently made aware that material information provided to the public in an announcement is inaccurate, incomplete and/or misleading, the Company is advised to report the same to the Exchange immediately and issue a clarification announcement as soon as practicable. We would recommend that the Company should reflect on the lessons to be learnt from the circumstances described in this letter and implement appropriate changes to ensure that appropriate checks and balances are installed by which the accuracy of information given to shareholders and the market is ensured.
4. We would also remind you that the announcement, circular and shareholders' approval requirements of connected transactions must be satisfied by an issuer before or at the time when the issuer enters into the transaction, not after the transaction has already been entered into. The Company's attention is drawn to the following:
 - (a) Rule 14A.35~~14A.47~~ of the Listing Rules requires an issuer ~~proposing to enter into a connected transaction to notify and to send a draft announcement to the Exchange to announce the connected transaction as soon as practicable possible after its the terms of the transaction have been agreed~~; and
 - (b) Rule 14A.36~~14A.52~~ also requires the connected transaction to be made conditional on approval by independent shareholders ~~at the time when the issuer enters into the transaction~~.

Invitation to Comment

We invite the board of directors of the Company to comment on this letter if they wish. Your submission, together with this letter, will be placed on the Company's compliance file. No further action will be taken in respect of this matter which is now considered closed.

Publicity

We wish to inform you that, at an appropriate time, the Division may, in the discharge of its regulatory function, publicize certain facts and guidance given in this letter. This would be done on an anonymous and redacted basis, to explain our views on the issues raised by this case for the benefit of the market as a whole. If such disclosure is made it may be published on our website and in our quarterly publication "Exchange".

Yours faithfully,
For and on behalf of
The Stock Exchange of Hong Kong Limited

[Signed]
[Authorised Signatory]