

HKE_x LISTING DECISION

Cite as HKE_x-LD76-5 (October 2009) (Updated in July 2010) (Withdrawn in July 2014)

[See Main Board Rules 14A.12(2)(b) and 14A.21]

Summary	
Parties	<p>Company A – a Main Board listed company</p> <p>Director A, Director B and Director C – each an executive director of Company A</p> <p>The Target – a private company acquired by Company A</p> <p>Mr X – Director A’s nephew, and the vendor who sold the Target to Company A</p> <p>The Supplier – a private company which proposed to supply raw materials to Company A</p> <p>Mr Y – Director B’s brother, and having a majority interest in the Supplier</p> <p>The Borrower – a private company who proposed to borrow money from Company A</p> <p>Mr Z – Director C’s brother-in-law, and a director and controlling shareholder of the Borrower</p>
Subject	<p>Whether the transaction between Company A and each of Mr X, the Supplier and the Borrower was subject to the connected transaction requirements</p>
Listing Rules	<p>Main Board Listing Rules 14A.06, 14A.11(4)(c)¹</p>
Decision	<p>The Acquisition, the Purchase and the Loan Transaction were each subject to the connected transaction requirements.</p>

SUMMARY OF FACTS

1. Company A was principally engaged in the retail business and property investment and management. It sought the Exchange’s view on whether the following transactions constituted connected transactions.

The Acquisition

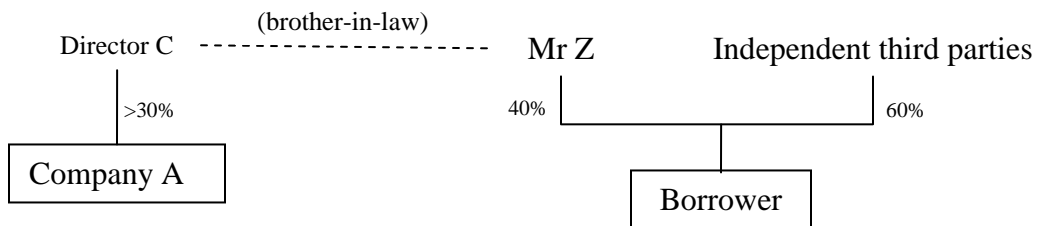
2. Company A acquired from Mr X his entire interest in the Target (the **Acquisition**).
3. Mr X was Director A's nephew. Before the Acquisition, Mr X had borrowed a sum of money from Director A to finance Mr X's investments in Mainland China including the Target. Director A submitted that he did not in any way otherwise involve himself in the Target's operations. Mr X repaid Director A using part of the consideration received from the Acquisition.

The Purchase

4. Company A proposed to purchase certain materials from the Supplier for its ordinary and usual course of business (the **Purchase**).
5. Mr Y was a brother of Director B. The Supplier was owned as to 80% by a company in which Mr Y had a 60% interest. The Supplier had three directors which included Mr Y and his spouse.

The Loan Transaction

6. Company A proposed to grant a loan to the Borrower (the **Loan Transaction**). The loan would be provided on normal commercial terms and secured by a property owned by the Borrower. The Borrower was engaged in property investment and management business.
7. Mr Z was Director C's brother-in-law. Both Mr Z and Director C were directors of the Borrower. The simplified shareholding structure of Company A and the Borrower is set out below:



8. Company A submitted that:
 - Mr Z invited Director C to join the Borrower's board because of Director C's experience in the property business.

- The Borrower was referred to Company A by Director C. However, Director C was not involved in the negotiation of the Loan Transaction. He had abstained from voting in the board meeting of each of Company A and the Borrower to approve the Loan Transaction.
- Director C did not have any shareholding in the Borrower. Company A took the view that the Loan Transaction would not confer any benefit on him.
- The Loan Transaction would enable Company A to earn interest income. Company A's independent non-executive directors considered that the Loan Transaction was in the interest of Company A and its shareholders.

ISSUES

9. Whether the Acquisition, the Purchase and the Loan Transaction each was subject to the connected transaction requirements.

APPLICABLE LISTING RULES OR PRINCIPLES

10. Rule 14A.06 provides that:

The Exchange has the specific power to deem a person to be connected (see rule 14A.11(4)) ...

11. Rule 14A.11¹ provides that for the purposes of Chapter 14A, the definition of "connected person" includes:

(1) a director, chief executive or substantial shareholder ... of the listed issuer;

...

(4) any associate of a person referred to in rules 14A.11(1) In this Chapter, an "associate" of a person referred to in rules 14A.11(1) ... includes the following additional persons:-

...

(b) ... and any ... brother, ... of, a person referred to in rules 14A.11(1) ...; and

(c) a ... brother-in-law, ... nephew ... of a person referred to in rules 14A.11(1) ... whose association

with the person referred to in rules 14A.11(1) ... is such that, in the opinion of the Exchange, the proposed transaction should be subject to the requirements of this Chapter. Listed issuers must notify the Exchange of any proposed transaction with these parties unless the transaction is exempt under rules 14A.31 or 14A.33. Listed issuers must also provide information to the Exchange to demonstrate whether or not these parties should be regarded as associates of the person referred to in rules 14A.11(1);

...

ANALYSIS

12. The connected transaction rules seek to safeguard against connected persons taking advantage of their positions to the detriment of minority shareholders of the issuer.
13. Rule 14A.06 provides that the Exchange has the specific power to deem a person to be connected. This power is usually exercised in respect of a particular transaction. When applying Rule 14A.06, the Exchange considers all relevant facts and circumstances surrounding the transaction. Particular regard would be given to the substance rather than the form of the transaction and any arrangements that are designed to circumvent the spirit and intent of the connected transaction rules.

The Acquisition

14. The relationship and financing arrangement between Director A and Mr X demonstrated that Mr X had a close association with Director A concerning the Acquisition. It was possible for Director A to take advantage of his position in Company A to benefit himself and Mr X through the Acquisition. This case fell within Rule 14A.11(4)(c).

The Purchase

15. Mr Y was an associate of Director B and therefore a connected person. Since the Supplier was only an associate of Mr Y but not Director B, he did not fall into the definition of connected person in Rule 14A.11¹.
16. Mr Y held a majority interest in the Supplier and, together with his spouse, controlled the Supplier's board of directors. It was possible for Director B to take advantage of his position to benefit the Supplier through the Purchase. The

Exchange considered it necessary to deem the Supplier a connected person of Company A in light of the circumstances.

The Loan Transaction

17. Director C was a connected person of Company A under Rule 14A.11(1). Since the Borrower was only an associate of Mr Z but not Director C, it did not fall within the definition of connected person under Rule 14A.11.
18. Nevertheless, the Exchange decided to deem the Borrower a connected person of Company A for the Loan Transaction because:
 - Director C was a brother-in-law of Mr Z who had a controlling interest in the Borrower. Director C was invited by Mr Z to join the Borrower's board of directors.
 - The Loan Transaction involved Company A granting a loan to the Borrower. Money lending activity was not Company A's ordinary and usual course of business.
 - The circumstances surrounding the Loan Transaction and Director C's association with Mr Z and the Borrower suggested that it was possible for Director C to take advantage of his position in Company A to benefit the Borrower through the Loan Transaction. The Exchange considered that the Loan Transaction should be subject to the connected transaction requirements and deemed the Borrower a connected person.

DECISION

19. The Acquisition, the Purchase and the Loan Transaction each was subject to the connected transaction requirements.

Note:

1. *Rule 14A.11(4) was amended in June 2010. Under the amended rule 14A.11(4), the definition of "associate" includes a company in which any of the connected person's relative referred to in paragraph (b) or (c) of the rule has a majority control (i.e. a control of more than 50% of the voting power at the company's general meetings or the composition of a majority of the company's board of director).*

Since Mr. Y and his spouse together had a majority control over the Supplier, it would be a connected person under the amended rule 14A.11(4). The Purchase is

therefore subject to the connected transaction requirements under the amended rules.

(Added in July 2010)