

Whether the proposed amendments to a non-competition undertaking given by the controlling shareholder to the listed issuer constituted a connected transaction

Parties

- **Company A** – a Main Board listed issuer
- **Newco** – a subsidiary of Company A before the proposed spin-off
- **Holding Company** – the controlling shareholder of Company A

Facts

1. Company A proposed to spin-off Newco for a separate listing on the Exchange. The proposal would involve Company A distributing all its interest in Newco in specie to the existing shareholders. Upon completion of the proposal, Company A would no longer hold any interest in Newco. Newco would become a connected person of Company A as the Holding Company would hold more than 50% interest in it.
2. Newco was principally engaged in the manufacturing and sale of certain products (the **Newco Business**).
3. At the time of Company A's new listing on the Exchange, the Holding Company and Company A had entered into a non-competition deed (the **Original Non-Competition Deed**), under which the Holding Company had undertaken to Company A not to, directly and indirectly, carry on or be engaged or interested in the principal businesses of Company A including the Newco Business.
4. In order to delineate the businesses of the Holding Company, Company A and Newco upon completion of the proposed spin-off, the parties would enter into the following non-competition arrangement (the **Revised Non-Competition Arrangement**):
 - the Holding Company and Company A would amend the Original Non-Competition Deed to exclude the Newco Business from the deed; and
 - the Holding Company would undertake to Newco not to, directly and indirectly, carry on or be engaged or interested in the Newco Business. While Company A would not be a party to such undertaking, the Holding Company would exercise its influence on Company A so as to cause Company A to comply with the undertaking.
5. There was an issue whether the Revised Non-Competition Arrangement would constitute a connected transaction for Company A, and if so, whether the de minimis exemption would apply as Company A considered that the arrangement was made on normal commercial terms and no consideration would be paid or received by it.

Relevant Listing Rules

6. Rule 14A.01 states that:

"This Chapter applies to connected transactions entered into by a listed issuer or its subsidiaries. The connected transaction rules ensure that the interests of shareholders as a whole are taken into account by the listed issuer when the listed issuer's group enters into a connected transaction."

7. Rule 14A.25 states that:

"Any transaction between a listed issuer's group and a connected person is a connected transaction."

8. Rule 14A.36 states that:

"The connected transaction must be conditional on shareholders' approval at a general meeting held by the listed issuer. Any shareholder who has a material interest in the transaction must abstain from voting on the resolution."

9. Rule 14A.76 states that:

"This exemption applies to a connected transaction (other than an issue of new securities by the listed issuer) conducted on normal commercial terms or better as follows:

(1) The transaction is fully exempt if all the percentage ratios (other than the profits ratio) are:

(a) less than 0.1%;

(b) ...; or

(c) less than 5% and the total consideration...is less than HK\$3,000,000.

(2) The transaction is exempt from the circular (including independent financial advice) and shareholders' approval requirements if all the percentage ratios (other than the profits ratio) are:

(a) less than 5%; or

(b) less than 25% and the total consideration...is less than HK\$10,000,000."

(Rule 14A.76 was amended on 11 June 2024. See Note below.)

Analysis

10. In this case, Company A and the Holding Company proposed to enter into the Revised Non-Competition Arrangement which would confer a benefit on the Holding Company and its associates. It was a connected transaction for Company A.
11. The Revised Non-Competition Arrangement would restrict Company A from engaging in certain businesses, and the value of the transaction could not be quantified in monetary terms. The Exchange did not agree that the transaction would qualify for the de minimis exemption.



Conclusion

12. The Revised Non-Competition Arrangement required independent shareholders' approval under Chapter 14A.

Note: Rule 14A.76 was amended on 11 June 2024 to clarify that the de minimis exemption does not apply to a sale or transfer of treasury shares by a listed issuer. The Rule amendments would not change the analysis and conclusion in this case.